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C. Steven Bradford*

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Research for this article was made possible by a Ross McCollum Summer Research Grant. I am grateful to Professor Stephen E. Kalish for helpful comments on an earlier draft. I also wish to thank Gregory S. Heier, a 1988 graduate of the University of Nebraska College of Law, for his research assistance.

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I. INTRODUCTION

American business in the last twenty-five years has experienced an explosion in the number of hostile corporate takeovers. Attempts to acquire billion-dollar companies are becoming commonplace. Smaller takeovers barely attract the attention of the financial press. The likelihood of a tender offer has become another everyday concern of management, as much a part of the business landscape as sales figures and profit margins.

Proponents of hostile corporate takeovers argue that such takeovers generally benefit society and corporate shareholders. They provide a way to discipline the management of companies which are operating inefficiently or not returning the full value of their operations to the company's shareholders. They help produce synergistic combinations of companies to achieve economies of scale and a more rational organizational structure. They help insure that corporate assets end up in the hands of those able to use them most efficiently. In

the process, proponents argue that hostile takeovers provide value to target company shareholders that otherwise they would not have received.

Opponents argue that hostile takeovers have detrimental effects on both the corporation and on society as a whole. According to the opponents, hostile takeovers represent not an increase in corporate efficiency, but inefficient empire-building by the bidder. They result in an unhealthy increase in corporate indebtedness and force corporate management to focus on short-term profits at the expense of long-term economic growth. Opponents of hostile takeovers argue that target shareholders are coerced into selling their shares at less than their fair value. Even if the target shareholders are adequately compensated, opponents argue that hostile takeovers have a detrimental effect on the local community in which the target company operates, on employees of the target company, on creditors and other debtholders of the target, and on other constituencies which have no voice in the tender offer decision.

Congress reacted to the perceived abuses in tender offers in 1968, passing the Williams Act as an amendment to the Securities Exchange Act of 1934.¹ At that time, only one state, Virginia, had a statute directly regulating takeovers.² After the adoption of the Williams Act, states began to respond in kind; by 1979, thirty-seven states had enacted takeover statutes.³ This first generation of state statutes was subjected to continual constitutional attack until 1982 when the United States Supreme Court, in a greatly divided opinion, struck down the Illinois takeover statute.⁴ That decision was followed by a second generation of state statutes which changed their focus from direct regulation of tender offers to the use of procedural requirements in state corporation codes to protect the shareholders of the target company. The constitutionality of these second generation statutes remained in doubt until 1987, when the Supreme Court approved the constitutionality of the Indiana Control Share Acquisitions Chapter in *CTS v. Dynamics Corp. of America*.⁵ *CTS* was followed by the adoption of a number of state statutes mimicking and, in many cases, going beyond the Indiana statute.

The premise of this article is that most of the recent state legisla-

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1. The Securities Exchange Act of 1934 (hereinafter the "Exchange Act") appears at 15 U.S.C. §§ 78a-78kk (1982). The Williams Act is in sections 13 and 14 of the Exchange Act, 15 U.S.C. sections 78m-78n (1982).
 2. Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. ECON. 371, 377 (1980).
 3. R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 712 (6th ed. 1987).
 4. *Edgar v. MITE Corp.*, 457 U.S. 624 (1982). See *infra* text accompanying notes 94-114.
 5. 107 S. Ct. 1637 (1987). See *infra* text accompanying notes 115-143.

tion is ill-advised and misguided. The problems envisioned by the critics of hostile takeovers are either grossly exaggerated or nonexistent, and the statutes do little to eliminate those problems that may exist. Many of these statutes present serious constitutional problems. In addition, drafting errors and ambiguities have resulted in unintended consequences.

This article uses recent Nebraska legislation as a vehicle to examine takeovers and some of the problems with antitakeover legislation. In its 1988 legislative session, the Nebraska Legislature responded to the *CTS* decision by enacting its third in a series of corporate takeover bills, the Nebraska Shareholders' Protection Act.⁶ Although the appellation is appealing, it is a mischievous misnomer. The Act does not protect shareholders; it harms them. The Legislature's acceptance of the popular criticism of corporate takeovers has created a bill that promotes economic inefficiency and corporate waste at the expense of the shareholders the bill was designed to protect. The legislative rush to fall in step with other states and address the increasing number of corporate takeovers has resulted in a poorly drafted statute that is bad policy and partially unconstitutional.

II. PRIOR NEBRASKA LEGISLATION

The Nebraska Shareholders' Protection Act is the Nebraska Legislature's third attempt to restrict corporate takeovers. The original Nebraska statute dealing with corporate takeovers,⁷ passed in 1977, applied to offers for the stock of any corporation which was incorporated in Nebraska, had its principal place of business or principal executive office in Nebraska, or had substantial assets in Nebraska.⁸

The 1977 Act required a person making an offer which, if successful, would make the offeror a ten percent owner of a corporation's stock to publicly announce the terms of the offer and to file a disclosure statement with both the Nebraska Department of Banking and Finance and the target company.⁹ An offer automatically became ef-

6. NEB. REV. STAT. §§ 21-2432 to -2453 (Cum. Supp. 1988) [hereinafter "Shareholder Protection Act," the "Nebraska Act," or "the Act"]. For a description of the Act's contents, see *infra* text accompanying notes 38-93. For a discussion of the two earlier statutes, see *infra* text accompanying notes 7-37.

7. NEB. REV. STAT. §§ 21-2401 to -2417 (1977)(repealed 1983). This statute, popularly known as the Corporate Takeover Act, will be referred to as the 1977 Act.

8. *Id.* § 21-2401(1). Regulated insurance companies were excluded, *id.* § 21-2417, as were certain transactions involving regulated public utilities, public utility holding companies, banks, bank holding companies, and savings and loan holding companies. *Id.* § 21-2416.

9. *Id.* §§ 21-2402, 21-2401(1). The information to be included in the disclosure statement was specified in section 21-2404. This section also contained a catch-all category requiring the offeror to disclose "[s]uch other and further documents, exhibits, data, and information as may be required by regulations of the depart-

fective and could proceed twenty days after the disclosure statement was filed.¹⁰ However, the Department of Banking and Finance could summarily delay effectiveness if the statement did not contain all of the required information or otherwise did not fully disclose all material information.¹¹ The Department had investigatory powers, including subpoena power,¹² and could call a hearing to investigate the offer.¹³ If a hearing was called, the offer could not be made until the Department declared it effective.¹⁴ The hearing had to be completed within twenty days of the disclosure statement filing,¹⁵ and the Department's determination as to whether the offer could proceed had to be made within thirty days of the filing date.¹⁶ The Department could stop an offer if it found that the offeror did not "provide for full and fair disclosure to offerees of all material information concerning the offer."¹⁷ An offeror was also subject to criminal liability, injunctive relief, and liability for damages.¹⁸

The 1977 Act also placed substantive restrictions on the terms of the offer. Takeovers were prohibited if the offeror had, within one year of the offer, become a five percent shareholder without disclosing his intent to make the offer.¹⁹ The offer had to be open to all holders of the security residing in Nebraska, and had to offer the same terms to Nebraska residents as were offered to non-residents.²⁰ If more securities were tendered than the offeror was willing to buy, the offeror had to purchase from all shareholders on a pro rata basis.²¹ All tendering shareholders were given an unconditional right to withdraw their shares during the first fifteen days of the offer.²² Any increase

ment, or as may be necessary to make fair, full and effective disclosure to offerees of all information material to a decision to accept or reject the offer." *Id.* § 21-2404(8).

10. *Id.* § 21-2405.

11. *Id.* § 21-2402.

12. *Id.* § 21-2415. The department's subpoena power was defined in section 8-1115 of the Nebraska Revised Statutes.

13. *Id.* § 21-2405.

14. *Id.*

15. *Id.* § 21-2406.

16. The 1977 Act required that the determination be made within twenty days of the filing, but allowed the Department a ten-day extension. *Id.*

17. *Id.*

18. *Id.* § 21-2415. The penalties provided for by the 1977 Act were found in sections 8-1116, 8-1117, and 8-1118 of the Nebraska Revised Statutes.

19. *Id.* § 21-2403.

20. *Id.* § 21-2409. Federal law imposed no such requirements at the time, but similar requirements were adopted by the SEC in 1986. 17 C.F.R. § 240.14d-10 (1987). See Amendments to Tender Offer Rules, Exchange Act Release No. 23,421, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (Sept. 4, 1986).

21. NEB. REV. STAT. § 21-2409 (1977)(repealed 1983). The Williams Act already imposed such a requirement. 15 U.S.C. § 78n(d)(6) (1982).

22. NEB. REV. STAT. § 21-2410 (1977)(repealed 1983). The Williams Act allowed withdrawal during the first seven days of the offer. 15 U.S.C. § 78n(d)(5). In 1980, the

in the consideration offered had to be paid to all security holders, even those who had already tendered at the lower price.²³ Finally, if the offeror entered into a business combination with the target within one year after the offer, the offeror was obligated to pay the remaining shareholders at least the highest per share price the offeror paid to acquire his stock.²⁴

In 1983, the Nebraska Legislature repealed the 1977 Act and adopted a new Corporate Takeover Act.²⁵ The 1983 Act was a scaled-down version of the 1977 Act. It applied to any corporation with thirty-five or more shareholders residing in Nebraska²⁶ and required a disclosure statement similar to that required by the 1977 Act,²⁷ but disclosure did not have to be made until public announcement of the offer.²⁸ The 1983 Act continued the one-year ban on takeovers where the offeror had become a five percent shareholder without disclosing his intent to make the subsequent bid.²⁹ However, the 1983 Act eliminated the other substantive restrictions on the terms of the offer.³⁰

The 1983 Act considerably restricted the powers of the Department of Banking and Finance. Although the standard of the Department's review was essentially the same,³¹ the Department had no administrative power to stop or delay the offer, nor was Department approval necessary to proceed with the offer. The Department could stop the

SEC increased the withdrawal period to 15 days. 40 Fed. Reg. 70,345 (1979)(superse-
ded in 1986 by 17 C.F.R. § 240.14d-7). See Tender Offers, Exchange Act Release
No. 16,384 [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373 (Nov. 29,
1979). In 1986 the SEC amended its rules to allow the withdrawal of tendered
shares at any time while the offer is open. 17 C.F.R. § 240.14d-7 (1987). See
Amendments to Tender Offer Rules, Exchange Act Release No. 23,421, [1986-87
Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (Sept. 4, 1986).

23. NEB. REV. STAT. § 21-2403 (1977)(repealed 1983). This requirement was already
imposed by § 14(d)(7) of the Williams Act. 15 U.S.C. § 78n(d)(7) (1982).

24. NEB. REV. STAT. § 21-2411 (1977)(repealed 1983). "Business combination" was de-
fined less expansively than in the current Nebraska Shareholders' Protection Act
but included a merger, consolidation, or sale or lease of any substantial part of the
target's assets. *Id.*

25. *Id.* §§ -2418 to -2430 (1983)(repealed 1988) [hereinafter the 1983 Act].

26. *Id.* § 21-2420(4). Regulated insurance companies were excluded, *id.* § 21-2430, as
were certain transactions involving regulated banks, bank holding companies,
and savings and loan holding companies. *Id.* § 21-2429.

27. Compare *id.* § 21-2423 with NEB. REV. STAT. § 21-2404 (1977).

28. NEB. REV. STAT. § 21-2421 (1983)(repealed 1988).

29. *Id.* § 21-2422.

30. This was probably because many of those substantive requirements were already
imposed by federal law. See *supra* notes 20-23.

31. The Department's duty was to determine whether the offeror had complied with
the Act and "whether the offeror has provided full and fair disclosure to offerees
of all material information concerning the takeover bid including the filing of a
complete and accurate registration statement." NEB. REV. STAT. § 21-2428(1)
(1983)(repealed 1988).

offer only by obtaining an injunction in state district court.³² Even the district court could not completely halt the offer but could only enjoin offers to or purchases from Nebraska residents.³³ Offerors violating the 1983 Act were also subject to criminal penalties and liability for damages via the Act's incorporation of the liability provisions of the Nebraska Securities Act.³⁴

Tender offerors repeatedly challenged the constitutionality of both the 1977 Act and the 1983 Act, and the enforcement of those Acts was consistently restrained.³⁵ The Nebraska Attorney General also issued

32. *Id.* § 21-2428(2), (3). See also *id.* §§ 21-2427, 8-1116.

33. *Id.* § 21-2428(2).

34. *Id.* § 21-2427. The liability provisions of the Nebraska Securities Act were found in sections 8-1117 and 8-1118.

35. For successful challenges to the 1977 Act in Nebraska District Court, see Kreifel, *Takeover Act Enforcement Halted*, Lincoln J., June 27, 1981, at 15, col. 2 (restrained enforcement of the 1977 Act against E.A. Development in its bid for Texasgulf); Kreifel, *Urbom Enjoins Takeover Action*, Lincoln J., July 6, 1981, at 13, col. 1 (entered a preliminary injunction in the same case); Marlette, *Takeover Act Restrained in Mobil-Marathon Case*, Lincoln J., Nov. 2, 1981, at 6, col. 3 (restrained enforcement of the 1977 Act against Mobil Oil in its bid for Marathon Oil); Kelly, *Corporate Takeover Act Remains Untouched*, Lincoln Sunday Journal-Star, Feb. 7, 1982, at C10, col. 2 (restrained enforcement of the 1977 Act against Whittaker Corporation in its bid for Brunswick Corporation); Marlette, *State Takeover Law Blocked in Court*, Lincoln J., June 5, 1982, at 4, col. 5 (restrained enforcement of the 1977 Act against Cities Service in its bid for Mesa Petroleum); *Occidental's Protest of Takeover Act Upheld*, Lincoln Star, Aug. 20, 1982, at 11, col. 1 (restrained enforcement of the 1977 Act against Occidental Petroleum in its bid for Cities Service); *State's Takeover Law Blocked A Second Time*, Lincoln J., Aug. 30, 1982, at 5, col. 5 (restrained enforcement of the 1977 Act against Bendix in its bid for Martin Marietta).

For successful challenges to the 1983 Act in Nebraska District Court, see Missouri Public Service Co. v. Amen, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,488 (D. Neb. June 22, 1983) (restrained enforcement of the 1983 Act against Missouri Public Service Company in its bid for The Gas Service Company); *Takeover Law Leashed Again*, Lincoln J., Dec. 31, 1983, at 4, col. 1 (restrained enforcement of the 1983 Act against Pennzoil in its bid for Getty Oil); Kreifel, *State Takeover Law Enjoined Again*, Lincoln J., Feb. 24, 1984, at 21, col. 5 (enjoined enforcement of the 1983 Act against Gulf Investors Group in its bid for Gulf Corporation of Pennsylvania); *Takeover Act Challenged in Federal Court*, Lincoln J., Mar. 9, 1984, at 12, col. 4 (restrained enforcement of the 1983 Act against Standard Oil of California in its bid for Gulf Corporation of Delaware); *State's Takeover Act Restrained Again*, Lincoln J., Apr. 14, 1984, at 9, col. 4 (restrained enforcement of the 1983 Act in connection with three separate offers: The Limited's bid for Carter Hawley Hale Stores, SPNV Holdings' bid for Shell Oil, and Hanson Trust's bid for U.S. Industries); *Judge Halts Implementing of Corporate Takeover Act*, Lincoln J., Dec. 11, 1984, at 9, col. 1 (restrained enforcement of the 1983 Act against Mesa Partners in its bid for Phillips Petroleum); *Turner's CBS Suits Include Challenge of Nebraska Law*, Lincoln J., Apr. 19, 1985, at 2, col. 4 (restrained enforcement of the 1983 Act against Turner Broadcasting System in its bid for CBS).

In the committee hearing and again in the legislative debate on L.B. 1110, Senator Schmit, who introduced the bills that became the 1977 and 1983 Acts, indi-

two opinions concluding that the 1983 Act was unconstitutional.³⁶ Not a single case was found allowing enforcement of either Act.³⁷

III. A REVIEW OF THE NEBRASKA SHAREHOLDERS' PROTECTION ACT

The Nebraska Shareholders' Protection Act differs in focus from the two earlier Nebraska statutes. Instead of directly regulating takeovers, it attempts to limit the power of a successful tender offeror to control the target corporation. It is also more limited than the earlier statutes in terms of the target corporations covered. Designed to make the Act constitutional, each of these changes makes the Act less effective than the earlier statutes in preventing hostile takeovers.

A. What Corporations Are Covered?

No corporation, Nebraska or foreign, is covered by the Act unless it has at least 100 shareholders.³⁸ The Act also excludes corporations that do not have a class of voting stock listed on a national securities exchange or are not authorized for quotation on an interdealer quotation system of a registered national securities association.³⁹ Thus,

cated that the 1983 Act "was never challenged in the court." *Shareholders' Protection Act, 1988: Hearings on L.B. 1110 Before the Committee on Banking, Commerce & Insurance, 90th Leg., 2d Sess. 38* (Feb. 1, 1988)[hereinafter *Hearings*]; *Shareholders' Protection Act, 1988: Legislative Debate on L.B. 1110, 90th Leg., 2d Sess. 9359* (March 8, 1988)[hereinafter *Debate*]. The challenges listed above show that Senator Schmit was clearly wrong on this point. Perhaps he meant that no case challenging the 1983 Act ever reached a final determination.

36. Op. Neb. Att'y Gen. No. 88 (April 21, 1983); Op. Neb. Att'y Gen. No. 103 (May 4, 1983). The latter opinion, given after an amendment to the statute that limited injunctive relief to offers to or purchases from Nebraska residents, is much more equivocal. It termed the answer "far from crystal clear" but nevertheless indicated a belief that the Act was unconstitutional.
37. The closest either Act came to surviving a constitutional challenge was two dismissals holding that the Acts did not apply to the particular takeover. See Kreifel, *Urbom Enjoins Takeover Action*, Lincoln, J., July 6, 1981, at 13, col. 1. (dismissed challenge by Seagram Company because its target, St. Joseph Minerals, did not have "substantial assets" in Nebraska and the 1977 Act therefore did not apply); Kreifel, *Urbom Denies Acklie Request Concerning Bank Stock Offer*, Lincoln J., Aug. 26, 1983, at 22, col. 1 (refused to enjoin enforcement of the 1983 Act because the parties agreed that the target, First National Bank of Lincoln, fell within the statutory exception for regulated banks or bank holding companies).
38. NEB. REV. STAT. §§ 21-2442(1)(a), (2)(b) (Cum. Supp. 1988).
39. *Id.* § 21-2453(4). This exception does not apply if the corporation has no such stock as a result of action taken by the interested shareholder or as a result of a transaction in which a person becomes a listed shareholder. *Id.*

There are ten national securities exchanges registered with the Securities Exchange Commission ("SEC") pursuant to section 6 of the Exchange Act. T. HAZEN, *THE LAW OF SECURITIES REGULATION* 259-260 (1985). The only national securities association currently registered with the SEC pursuant to section 15A

most smaller, privately owned companies are excluded.

The Act applies both to corporations incorporated in Nebraska and to foreign corporations, but the requirements for coverage are different.⁴⁰ A Nebraska corporation must meet at least one of the four following requirements to be covered by the Act: (1) it must have its principal executive offices in Nebraska;⁴¹ (2) it must have assets in Nebraska with a market value of at least ten million dollars;⁴² (3) ten percent or more of its shareholders must reside in Nebraska;⁴³ or (4) Nebraska residents must own more than ten percent of its shares.⁴⁴

A foreign corporation must have greater contacts with Nebraska to be covered by the Act. In addition to having at least 100 shareholders and being listed on an exchange or with the NASD,⁴⁵ a foreign corporation must meet all of the following requirements: (1) its principal executive offices must be in Nebraska; (2) it must have assets in Nebraska with a market value of at least ten million dollars; (3) it must have at least 500 employees in Nebraska; and (4) either ten percent of its shareholders must be Nebraska residents or Nebraska residents must own ten percent of its shares.⁴⁶

There are more than 32,000 for-profit corporations incorporated in

of the Exchange Act is the National Association of Securities Dealers ("NASD"). T. HAZEN, *THE LAW OF SECURITIES REGULATION* 259 (1985).

40. The term "foreign corporation" is used in this article to refer to a corporation incorporated in a state other than Nebraska. The terms "domestic corporation" and "Nebraska corporation" are used to refer to a corporation incorporated in Nebraska.

41. NEB. REV. STAT. § 21-2442(1)(b)(i) (Cum. Supp. 1988). "Principal executive offices" is not defined.

42. *Id.* § 21-2442(1)(b)(ii). The "market value" of assets other than stock or cash is their fair market value on the date in question as determined in good faith by the board of directors of the issuing public corporation. *Id.* § 21-2448(2). The market value of stock held by the corporation is determined using listed prices or quotes, if available. *See id.* § 21-2448(1)(a), (b). Otherwise, the market value of stock is also determined based on a good faith valuation by the board. *Id.* § 21-2448(1)(c). The Act does not say when the board must make its determination of market value, nor does it require the board to notify an offeror of its determination. This makes it possible that offerors will not know whether the Act applies to their offer. *See, e.g.,* TLX Acquisition Corp. v. Telex Corp., 679 F. Supp. 1022, 1027 (W.D. Okla. 1987) (offeror claimed it had to submit interrogatories to the target to ascertain whether Oklahoma's Control Shares Act applied). Another problem with the assets test is determining the situs of intangible assets such as stock, accounts receivable, patents, and goodwill. When are such intangible assets considered to be located in Nebraska?

43. NEB. REV. STAT. § 21-2442(1)(b)(iii) (Cum. Supp. 1988). A shareholder's residence is presumed to be the address appearing on the corporation's records. *Id.* § 21-2442(1).

44. *Id.* § 21-2442(1)(b)(iii).

45. *Id.* §§ 21-2442(2)(a), 21-2453(4). *See supra* notes 38-39 and accompanying text.

46. NEB. REV. STAT. § 21-2442(2) (Cum. Supp. 1988).

the State of Nebraska and more than 6,300 foreign corporations qualified to do business in the state.⁴⁷ Most of these, however, do not meet the requirements to be covered by the Act. It is difficult to estimate exactly how many corporations are covered by the Act, but the number is probably less than thirty.⁴⁸ Thus, the Act affects less than one-tenth of one percent of all the corporations incorporated or qualified to do business in Nebraska. It is nevertheless important because it affects large corporations that are important to the Nebraska economy.

The Act allows corporations that would otherwise be covered to opt out of the Act's coverage. However, the provisions for opting out are very limited. The board of directors of an existing public corporation may opt out by amending its bylaws within forty-five days of the effective date of the Act.⁴⁹ Once that election is made, it may not be revoked or amended by the board. However, the shareholders could amend the bylaws to bring the corporation back within the Act's coverage.⁵⁰ If an existing corporation does not opt out within forty-five

47. Telephone interview with Nebraska Secretary of State's office (June 21, 1988).

48. My research assistant reviewed two files available on the DIALOG Information Retrieval Service—File 527 (Standard and Poor's Register-Corporate) and File 133 (Standard and Poor's Corporate Descriptions). File 527 provides information on over 45,000 public and private companies. File 133 provides information on over 9,000 publicly owned corporations with securities trading on the New York, American, and regional stock exchanges, the NASDAQ system, and over-the-counter. The search of File 527 was limited to corporations described as public companies. The search of these two files produced a combined list of forty companies with their corporate offices in Nebraska. Of these forty companies, at least five clearly do not meet the additional requirements for inclusion. A few of the others, such as the Dawson County Public Power District, the Metropolitan Utilities District, the Nebraska Public Power District, and the Omaha Public Power District, are on the list only because they have issued debt securities and would not be subject to takeovers. This leaves a total of thirty-one companies which appear to be covered or for which insufficient information was available to determine whether they are covered. This includes several foreign corporations to which application of the Act may be unconstitutional. *See infra* text accompanying notes 144-71. This research sufficiently indicates the Act's limited application. No attempt was made to further refine the list. As to foreign corporations, the list should be overinclusive because it does not completely exclude corporations with insufficient Nebraska assets, employees, or shareholders. As to domestic corporations, the list conceivably could be underinclusive because it considers only Nebraska corporations with corporate headquarters in Nebraska. Nebraska corporations with headquarters elsewhere also could be covered by the Act. However, since Nebraska is not a hotbed for the incorporation of corporations located outside of the state, it seems safe to assume that all, or almost all, of the Nebraska corporations that would meet the other tests would be headquartered in Nebraska. Therefore, the list is probably overinclusive as to Nebraska corporations as well.

49. NEB. REV. STAT. § 21-2453(3) (Cum. Supp. 1988).

50. *See id.* § 21-2026 (1987)(corporate bylaws may be amended or repealed by the shareholders).

days of the Act's effective date, that election is irrevocable and the corporation becomes permanently covered by the Act.⁵¹ Newly formed corporations are covered unless their original articles of incorporation contain a provision expressly electing not to be covered.⁵²

B. Substantive Prohibitions

The Act contains two major substantive provisions affecting takeovers. First, the Act restricts the voting rights of shares acquired in a control-share acquisition.⁵³ Second, the Act prohibits certain transactions between the corporation and interested shareholders.⁵⁴

1. *The Voting Rights of Control Shares*

a. *The Limitation of Voting Rights*

Shares acquired in a control-share acquisition have the same right to elect directors as do other shares of the same class and series.⁵⁵

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51. The Act provides only two ways out: (1) through a bylaw amendment within forty-five days of the Act's effective date; and (2) through an opt-out provision in the corporation's *original* articles of incorporation. Any opt-out provision in an existing corporation's articles would be by amendment and by definition would not appear in the original articles of incorporation. Thus, an existing corporation which did not opt out within forty-five days after the effective date of the Act is forever barred from doing so.

The Shareholders' Protection Act as originally introduced would have allowed a majority of non-interested shareholders to vote to opt out of the Act at any time. However, this election would not have been effective for eighteen months and would have related only to persons who were not interested shareholders at the time of the opt-out vote. This provision was dropped when the committee amendments were accepted.

52. NEB. REV. STAT. § 21-2453(2) (Cum. Supp. 1988).

53. *Id.* § 21-2451. Hereinafter, "control shares" is used instead of the more awkward "shares acquired in a control-share acquisition" language employed in the Act.

54. *Id.* § 21-2452.

55. *Id.* § 21-2451. Most control-share acquisition statutes do not allow for the transfer of *any* voting rights. See, e.g., IND. CODE § 23-1-42-9(b) (1986). However, the Nebraska Constitution requires the Legislature to:

provide by law that in all elections for directors or managers of incorporated companies every stockholder owning voting stock shall have the right to vote in person or proxy for the number of such shares owned by him, for as many persons as there are directors or managers to be elected or to cumulate such shares . . . and such directors shall not be elected in any other manner.

NEB. CONST. art. XII, § 1.

Although there is nothing in the legislative history to support this conclusion, the drafters of the bill may have felt that taking away the right of control shares to elect directors might violate the constitutional requirement that "every stockholder owning voting stock . . . have the right to vote." This construction of the constitutional requirement is not self-evident. The constitution does not define "voting stock." It is at least arguable that the Legislature is free to define what is or is not "voting stock," and the constitution only requires that voting stock, however defined, be allowed to vote cumulatively. Thus, the Legislature might be

However, the holder of control shares has no right to vote those shares on other matters unless such voting rights are first approved by the holders of a majority of the non-interested shares entitled to vote.⁵⁶

An acquiring person may compel a special shareholders' meeting to consider the voting rights of shares that he has already acquired or is to acquire.⁵⁷ However, the corporation is required to call such a special meeting only if the acquiring shareholder files an information statement at the time of the request.⁵⁸ The information statement must: 1) identify the acquiring person and any affiliates and associates

able to circumvent the constitutional requirement and deny all voting rights to control shares simply by specifying that control shares are not "voting stock." The constitutionality of such a statute is unclear, as there is no Nebraska case law on the point.

56. NEB. REV. STAT. § 21-2451 (Cum. Supp. 1988). If any shares are entitled to vote as a class, a majority of the non-interested shares of that class must also approve voting rights. *Id.*

Section 21-2451 literally requires a majority vote of non-interested shareholders to approve the control share acquisition itself: "Any such control-share acquisition shall be approved by" *Id.* However, this appears to be a drafting oversight, because the rest of sections 21-2450 and 21-2451 deal exclusively with the approval of voting rights, and nothing in the statute itself refers to any prohibition on the transfer of the shares without majority approval, as long as the transferee is willing to accept reduced voting rights. *But see id.* § 21-2449(1)(e) (the information statement filed by the acquiring person shall include "such objective facts as would be substantially likely to affect the decision of a shareholder with respect to voting on the control-share acquisition") (emphasis added). In the floor debates, one of the bill's sponsors indicated that the Act does not prohibit anyone from acquiring stock; it only requires a vote to approve voting rights. *Debate, supra* note 35, at 9357 (statement of Sen. Johanns). *See also* Veere Inc. v. Firestone Tire & Rubber Co., 685 F. Supp. 1027 (N.D. Ohio 1988) (Ohio statute requiring shareholder approval of the acquisition itself upheld); Fleet Aerospace Corp. v. Holderman, 848 F.2d 720, 724-25 (6th Cir. 1988) (Kennedy, J., dissenting)(rejecting Ohio's argument that, for constitutional purposes, there is no practical difference between restricting voting rights and prohibiting the transfer of shares without shareholder approval).

57. NEB. REV. STAT. § 21-2450(1) (Cum. Supp. 1988). In order to compel a meeting, the acquisition must be completed or the subject of a bona fide written offer. *Id.* § 21-2450(1)(b). It is unclear what constitutes a bona fide offer. The issue of whether the offer is bona fide presents an opportunity for the management of the target corporation to delay the special meeting by contending that the offer is not bona fide. For example, is a tender offer made subject to financing bona fide? What if the offeror indicates that it is "highly confident" that such financing can be obtained? The SEC and at least one court have indicated that a tender offer may proceed even if financing is not completed. *See* Newmont Mining Corp. v. Pickens, 831 F.2d 1448 (9th Cir. 1987). Those decisions of course are not determinative in deciding for purposes of the Act whether an offer is bona fide.
58. NEB. REV. STAT. § 21-2450(1)(a) (Cum. Supp. 1988). An offeror is not required to file an information statement. *See id.* § 21-2449 ("An acquiring person may deliver . . . an information statement"). However, the written request for a special meeting must be made "at the time of delivery of the information statement," and the corporation has until "fifty days after receipt of the information statement" to honor the request. *Id.* § 21-2450(1)(a). Thus, if the acquiring person

of the acquiring person; 2) disclose the number of shares owned by each such person prior to the control-share acquisition; 3) disclose the number of shares acquired or to be acquired by each such person and the range of voting power that the acquiring person in good faith believes would result from the acquisition; and 4) disclose the terms of the acquisition, "including such objective facts as would be substantially likely to affect the decision of a shareholder with respect to voting on the control-share acquisition."⁵⁹ The acquiring person must also give the corporation a written undertaking agreeing to pay the expenses incurred by the target corporation in connection with the special meeting.⁶⁰

The special meeting, if properly requested, must be held within fifty days after receipt of the information statement, unless the acquiring person agrees to a later date.⁶¹ Although the board has latitude within the fifty-day period, the acquiring person by written request may force a thirty-day delay.⁶²

If the acquiring person does not properly request a special meeting, the Act provides that the shares' voting rights shall be considered at the next special or annual meeting "notice of which has not been given prior to the receipt of the information statement."⁶³ Thus, if no infor-

wants a special meeting to determine voting rights, the information statement must be delivered.

59. *Id.* § 21-2449(1). The information statement must be amended if there are any material changes in the facts disclosed. *Id.* § 21-2449(2).

60. *Id.* § 21-2450(1)(c). An interesting and important issue is whether the person seeking the special meeting must pay the target corporation's proxy solicitation expenses, or just the expenses of actually holding the meeting. Courts have held that proxy solicitation expenses are legitimate corporate expenses if the soliciting materials are designed to defend corporate policies and to inform the corporation's shareholders of the issues involved. *See Rosenfeld v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 (1955). A construction requiring the acquiring person to pay for the corporation's proxy expenses would force the acquiring person to finance opposition to his own tender offer. This construction should be rejected. The acquiring person is responsible for the cost of holding the meeting because the meeting would not have been held but for the acquiring person's request. This would include the cost of giving shareholders notice. However, the acquiring person is not responsible for costs the board, in its discretion, decides to incur to oppose the offer and, therefore, should not have to pay such costs. If the directors decide that opposition is in the best interests of the corporation, the corporation should pay for that opposition.

61. NEB. REV. STAT. § 21-2450(1) (Cum. Supp. 1988).

62. *Id.* Management would have to wait a minimum of ten days in any event because of the notice requirements for meetings of shareholders. *Id.* § 21-2029 (1987).

63. *Id.* § 21-2450(2) (Cum. Supp. 1988). This section presents an interesting opportunity to circumvent the requirement that the acquiring person pay the expenses of the special meeting. No undertaking to pay costs is required under section 21-2450(2), probably on the theory that the meeting would have been held in any event.

The simplest way for a bidder to use section 21-2450(2) is to make a tender offer and file an information statement just prior to the date that notices of the

mation statement is filed, the shareholders cannot vote to grant full voting rights to the shares.

An initial shareholder vote denying full voting rights may be irreversible, at least as long as the same person holds those shares. Nothing in section 21-2450 of the Act provides for reconsideration of voting rights after the initial shareholder meeting which considers the ques-

corporation's annual meeting are mailed. Section 21-2450(2) then would require consideration of the acquirer's voting rights at that annual meeting. However, once the information statement was filed, incumbent management could delay the vote temporarily and complicate the tender offer by withholding the notices and postponing the annual meeting. The NBCA provides that the annual meeting shall be held "at such time as may be stated in or fixed in accordance with the bylaws." *Id.* § 21-2027 (1987). Most corporate bylaws allow the board to set the date of the annual meeting. If the postponement delayed the annual meeting to a date more than thirteen months after the last annual meeting, any shareholder could get a summary order from the district court compelling the meeting. *Id.*

An alternative would be to use the ordinary NBCA special meeting procedures, rather than those specified in the Act. The holders of at least ten percent of the shares entitled to vote at a meeting may call a special meeting. *Id.* The acquiring person could not call a special meeting using these procedures because he would not be entitled to vote on his own voting rights, *id.* § 21-2451 (Cum. Supp. 1988), but the call might be made by friendly shareholders. A problem is that such friendly shareholders, in agreeing to call a special meeting, might themselves be treated as owning "interested shares" not entitled to vote. *See id.* §§ 21-2441, 21-2434. The agreement to call a special meeting on behalf of the acquiring person might be treated as an "agreement, arrangement, relationship, or understanding . . . for the purpose of acquiring, owning, or voting shares of an issuing public corporation." The NBCA does not say whether the shareholders calling a special meeting must pay for the expense of holding the meeting, nor has any Nebraska case addressed the issue. However, the inclusion of a special expense provision in section 21-2450(1) of the Act and the omission of such a provision in the NBCA support the conclusion that the corporation itself must bear the expenses associated with an ordinary special meeting. Thus, an acquiring person might avoid the expense reimbursement requirement of the Act by arranging for an ordinary NBCA special meeting.

A problem with using the ordinary NBCA special meeting provisions is that the acquiring person loses the timing advantages of section 21-2450(1) of the Act. The NBCA does not indicate when a corporation must hold a special meeting called by the shareholders. Although a court might impose a "reasonable time" requirement, a reasonable time could be longer than the fifty-day maximum specified in section 21-2450(1) of the Act. Thus, the benefit to the acquiring person of not having to pay for the special meeting could be offset by the possibility of additional delay. However, the NBCA provides that written notice to all shareholders specifying the time, date, and location of the special meeting may be delivered by the persons calling the meeting, in this case the cooperating shareholders. *Id.* § 21-2029 (1987). If they have access to a current shareholder list, those calling the special meeting on behalf of the acquiring person could specify their own meeting date which could be as early as ten days after the notice is mailed. *Id.* (notice to shareholders must be mailed at least ten days before the meeting). Thus, an acquiring person using the NBCA special meeting procedures could avoid not only the undertaking for expenses required by section 21-2450(1), but also might gain the strategic advantage of being able to set a quick meeting date.

tion, and section 21-2451 provides that such shares shall have full voting rights only if approved by the shareholders "at a special or annual meeting of shareholders *pursuant to the Shareholders' Protection Act.*"⁶⁴ Because the Act does not provide for any subsequent vote, an acquiring person who loses in the initial election apparently becomes permanently disenfranchised except as to the election of directors. Full voting rights could be restored to those shares in only two ways. First, the holder could transfer the control shares to unrelated persons whose acquisition of the shares would not constitute a control-share acquisition, in which case the shares would regain their full voting rights.⁶⁵ Second, the holder could transfer the shares to an unrelated person in a control-share acquisition and let that person go through the approval procedure.⁶⁶

b. What Shares Are Included—Groups and Related Parties

Only shares acquired in a control-share acquisition are subject to this loss of voting rights. The voting rights of shares owned by the acquiring person prior to the control-share acquisition are unaffected. A "control-share acquisition" is an acquisition, directly or indirectly, by an acquiring person⁶⁷ of the ownership of voting stock that, but for the Act, would raise the person's voting power to or above one of three thresholds: twenty percent, thirty-three and one-third percent, or fifty percent.⁶⁸ All shares acquired within a 120-day period or pursuant to a single plan are treated as part of the same control-share acquisition.⁶⁹

Ownership of stock is broadly defined to include the holdings of related parties and transactions involving less than an outright

64. *Id.* § 21-2451 (Cum. Supp. 1988)(emphasis added).

65. *Id.*

66. A transfer to a related person would, in effect, be no transfer at all, since that related person already would be treated as part of the acquiring person. See *infra* text accompanying notes 70-77.

67. In an amusing bit of circularity, the Act defines an "acquiring person" as one who makes or proposes to make a control-share acquisition. NEB. REV. STAT. § 21-2434 (Cum. Supp. 1988). The definition adds that two or more persons acting together may constitute a single acquiring person:

If two or more persons act as a partnership, limited partnership, syndicate, or other group pursuant to any agreement, arrangement, relationship, or understanding, whether or not in writing, for the purpose of acquiring, owning, or voting shares of an issuing public corporation, all members of the partnership, limited partnership, syndicate, or other group shall constitute a person for purposes of this section.

Id.

68. *Id.* § 21-2439. A person crosses the first two thresholds when that person's ownership *equals* either of the two specified percentages. A person crosses the third threshold only when the person's ownership *exceeds* fifty percent. *Id.*

69. *Id.*

purchase.⁷⁰ First, two or more persons acting as a partnership, syndicate, or group are treated as a single acquiring person.⁷¹ Ownership also includes acquisitions by affiliates or associates.⁷² "Associate" includes: 1) any entity of which the acquiring person is an officer, director, or partner, or as to which the acquiring person directly or indirectly owns at least ten percent of any class of voting stock; 2) any trust or estate in which the person has at least a ten percent beneficial interest or which the person serves as trustee, personal representative, or in a similar fiduciary capacity; and 3) any relative or spouse of the person, or any relative of the spouse, who has the same residence as the person.⁷³ "Affiliate" is a person who directly or indirectly controls, is controlled by, or is under common control with the acquiring person.⁷⁴ Control is defined as the power, directly or indirectly, to direct or cause the direction of the management and policies of the controlled person.⁷⁵ A person who owns at least ten percent of a corporation's outstanding voting stock is presumed to have control of that corporation, although that presumption is rebuttable.⁷⁶ However, voting power held as agent, bank, broker, nominee, custodian, or trustee for persons who do not themselves have control is not control, as long as such voting power is held in good faith and not for the purpose of avoiding the Act.⁷⁷

In addition to covering ownership by related persons, the definition of "owner" includes control of stock short of full title.⁷⁸ First, the Act looks to direct or indirect beneficial ownership, not record ownership. Second, a person owns stock if he has any agreement, understanding, or other right to acquire the stock, whether or not that right is immediately exercisable. However, this does not include stock which has been tendered pursuant to a tender offer, but not yet accepted. Third, ownership includes a right to vote the stock; however, a revocable proxy or consent given in response to a solicitation made to ten or more shareholders is excluded. Finally, ownership includes any agreement, arrangement, or understanding with any other person who beneficially owns or whose affiliates or associates beneficially own the stock, directly or indirectly, for the purpose of acquiring, holding, voting, or disposing of the stock. Again, a revocable proxy or consent given in response to a solicitation made to ten or more shareholders is excluded.

70. *Id.* § 21-2443.

71. *Id.* § 21-2434. *See supra* note 67.

72. NEB. REV. STAT. § 21-2443 (Cum. Supp. 1988).

73. *Id.* § 21-2436.

74. *Id.* § 21-2435.

75. *Id.* § 21-2438.

76. *Id.*

77. *Id.*

78. *Id.* § 21-2443.

The Act expressly excludes certain transactions from the definition of control-share acquisition.⁷⁹ All transactions consummated before the effective date of the Act, or pursuant to a contract existing before the effective date of the Act, are excluded. All purchases from a person who owns more than fifty percent of the corporation's voting stock and who acquired those shares prior to the effective date of the Act are excluded. Acquisitions pursuant to the laws of descent and distribution are excluded, as are acquisitions in satisfaction of a pledge or security interest, as long as the pledge or security interest was created in good faith and not for the purpose of circumventing the Act. Finally, acquisitions pursuant to a merger or share exchange with the issuing public corporation are excluded.⁸⁰

2. *The Five-Year Prohibition of Business Combinations*

The Act generally prohibits business combinations between an interested shareholder and the issuing public corporation for a period of five years after the interested shareholder's share acquisition date.⁸¹ However, section 21-2452 does not apply where the target board gave advance approval to the business combination or the acquisition of shares before the person became an interested shareholder.⁸² There is no exception for business combinations approved by the other shareholders, no matter how many disinterested shareholders approve the transaction. No business combination is allowed even if all disinterested shareholders approve.

a. *Who is an Interested Shareholder?*

An "interested shareholder" is any person, other than the issuing public corporation or a subsidiary of the issuing public corporation, who directly or indirectly owns ten percent or more of the corporation's outstanding voting stock.⁸³ The term also includes any affiliate or associate of the issuing public corporation or its subsidiaries that owned ten percent or more of the outstanding voting stock at any time

79. *Id.* § 21-2439.

80. *Id.* This exception allows voting rights to pass in transactions agreed to by the target board and approved by the shareholders. *See infra* text accompanying notes 378-80.

81. NEB. REV. STAT. § 21-2452 (Cum. Supp. 1988). The "share acquisition date" is the date on which the person first becomes an interested shareholder. *Id.* § 21-2445.

82. *Id.* § 21-2452. Thus, the prohibition could be circumvented by a proxy fight to gain control of the board prior to the acquisition.

83. *Id.* § 21-2440(1). In calculating the number of outstanding shares, any unissued shares which may be issuable pursuant to any agreement, arrangement, or understanding or upon the exercise of conversion rights, warrants, options, or otherwise, are ignored, unless they are deemed to be owned by the interested shareholder. *Id.* § 21-2440.

within the prior five-year period.⁸⁴ However, the ban on business combinations does not apply if the interested shareholder was an interested shareholder prior to the effective date of the Act, unless the person subsequently increases his proportionate ownership without the approval of the board.⁸⁵ The business combination restriction also does not apply where the person inadvertently becomes an interested shareholder and divests sufficient shares "as soon as practicable" to lose that status.⁸⁶

b. What Transactions are Prohibited?

The Act's definition of business combination is comprehensive and thorough.⁸⁷ It includes a merger or consolidation between the issuing public corporation, or its subsidiary, and the interested shareholder, or any affiliate or associate of the interested shareholder.⁸⁸ It also includes "[a]ny sale, lease, exchange, mortgage, pledge, transfer, or other disposition" of any assets of the issuing public corporation or its subsidiary to the interested shareholder or to any affiliate or associate of the interested shareholder.⁸⁹ However, no transfer of assets is a "business combination" unless the assets transferred have an aggregate market value of at least ten percent of (1) the aggregate market value of the issuing public corporation's assets, or (2) the aggregate market value of all the outstanding shares of the issuing public corporation.⁹⁰ The third prohibited business combination is an issuance or transfer to the interested shareholder of stock of the issuing public corporation or its subsidiary with an aggregate market value of at least five percent of the aggregate market value of all the outstanding shares. Dividends or distributions issued pro rata to all shareholders, the exercise of warrants offered or distributed pro rata to all shareholders, and the conversion of convertible securities outstanding before the person became an interested shareholder are excluded.⁹¹

The fourth prohibited business combination is any transaction directly or indirectly increasing the interested shareholder's proportion-

84. *Id.* § 21-2440(2). See *supra* text accompanying notes 73-77, for definitions of "affiliate" and "associate."

85. NEB. REV. STAT. § 21-2453(1) (Cum. Supp. 1988). Inadvertent increases in such a person's proportionate ownership after the effective date of the Act do not invoke the ban on business combinations if the person divests himself of sufficient shares to return to his original proportionate ownership.

86. *Id.* § 21-2453(5).

87. See *id.* § 21-2437.

88. *Id.* § 21-2437(1). This includes corporations that are affiliates or associates either before or after the merger or consolidation.

89. *Id.* § 21-2437(2).

90. *Id.* § 21-2437(2)(a), (b).

91. *Id.* § 21-2437(3).

ate ownership of any stock or securities convertible into stock.⁹²

Finally, the interested shareholder or its affiliates or associates may not directly or indirectly receive the benefit of any loans, guarantees, pledges, financial assistance, tax credits, or tax advantages from the issuing public corporation or a subsidiary unless those benefits are shared proportionately with other shareholders.⁹³

IV. IS THE NEBRASKA ACT CONSTITUTIONAL?

The Nebraska Act poses serious constitutional problems. The Act's application to foreign corporations is clearly unconstitutional. Although the control share part of the Act closely mirrors the Indiana statute approved by the United States Supreme Court and therefore is probably constitutional, the business combination part of the statute may be unconstitutional even as applied to Nebraska corporations.

A. The Supreme Court's Review of Antitakeover Statutes

1. *Edgar v. MITE Corp.*

Consideration of the Nebraska Act's constitutionality must begin with the two United States Supreme Court cases reviewing the constitutionality of state antitakeover statutes. The Supreme Court's first review of a state statute restricting corporate takeovers came in *Edgar v. MITE Corp.*,⁹⁴ which involved the constitutionality of the Illinois Business Take-Over Act.⁹⁵ The Illinois Act was similar to the 1977 Nebraska Act. It applied to tender offers for any corporation's equity securities if Illinois shareholders owned ten percent or more of the security subject to the offer. It also applied to corporations not meeting that test if at least two of the following requirements were satisfied: (1) the corporation had its principal executive offices in Illinois; (2) the corporation was incorporated in Illinois; or (3) the corporation had at least ten percent of its stated capital and paid-in surplus represented within Illinois.

No tender offer could be made for the stock of a company covered by the Illinois Act unless the offeror first filed a registration statement with the Illinois Secretary of State. The registration statement automatically became effective and the offer could commence after twenty days, but the Secretary could call a hearing during the twenty-day waiting period if he felt it was necessary to protect the target

92. *Id.* § 21-2437(4). This includes stock owned directly or indirectly by the interested shareholder. The only exception is for immaterial changes due to fractional share adjustments.

93. *Id.* § 21-2437(5).

94. 457 U.S. 624 (1982).

95. ILL. REV. STAT. ch. 121 1/2, § 137.51 to .70 (Supp. 1979), *repealed by* P.A. 83-365 § 1 (effective Sept. 14, 1983).

shareholders. A hearing was mandatory if requested by a majority of the target's outside directors or by Illinois shareholders owning ten percent of the securities subject to the offer. If a hearing was called, the offer could not proceed until the hearing process was completed. The Secretary could permanently enjoin the offer if he found that it (1) did not fully and fairly disclose all material information; (2) was inequitable; or (3) would defraud or deceive the offerees.

MITE made a cash tender offer for all of the outstanding shares of Chicago Rivet & Machine, an Illinois corporation. Twenty-seven percent of Chicago Rivet's shareholders resided in Illinois, so the Illinois Act applied. MITE challenged the Illinois Act on two grounds: first, that it was unconstitutional under the supremacy clause because it was preempted by the federal Williams Act regulating tender offers; and second, that it was in violation of the dormant commerce clause. The United States District Court for the Northern District of Illinois issued a preliminary injunction prohibiting the Illinois Secretary of State from enforcing the Illinois Act and the United States Court of Appeals for the Seventh Circuit affirmed.⁹⁶

The Supreme Court reached a majority decision only on the commerce clause question, although a three-judge plurality also would have held the Illinois Act preempted by the Williams Act.⁹⁷

Relying primarily on the Court's opinion in *Pike v. Bruce Church, Inc.*,⁹⁸ the commerce clause portion of Justice White's opinion began by stating that a state statute violates the commerce clause only if it directly regulates interstate commerce or if the burden the statute imposes on interstate commerce is excessive when compared to the local interests the statute purports to further.⁹⁹ Four justices would have held that the Illinois Act was an invalid direct restraint on interstate commerce. The plurality noted that the Act could be applied to a

96. *MITE Corp. v. Dixon*, 633 F.2d 486 (7th Cir. 1980).

97. Justices Marshall, Brennan, and Rehnquist would have held the case moot and did not discuss the merits of either constitutional challenge. *Edgar v. MITE Corp.* 457 U.S. 624, 655, 664 (1982). Justice White, joined by Justices Burger and Blackmun, would have held that the Williams Act preempted the Illinois Act. *Id.* at 626. In separate opinions, Justices Powell and Stevens rejected this preemption conclusion. *Id.* at 646-47. Justice Powell agreed that the case was moot but nevertheless addressed the merits. *Id.* at 646. Justice O'Connor found it unnecessary to reach the preemption issue. *Id.* at 655. Justice White's opinion on the commerce clause challenge was joined in full by Justices Burger, Stevens, and O'Connor. Justice Powell joined only one part of the commerce clause opinion, producing a majority only as to that portion of the opinion. Justice Blackmun did not join the commerce clause portion of Justice White's opinion. *Id.* at 626.

98. 397 U.S. 137 (1970).

99. *Edgar v. MITE Corp.*, 457 U.S. 624, 640 (1982). Because Justice Powell joined only Part V-B of the opinion, a majority of the Court did not join in the general discussion of the commerce clause standard of review.

tender offer for a corporation without a single Illinois shareholder.¹⁰⁰ Even if there were Illinois shareholders, the Illinois Act would prevent MITE from making its offer to all shareholders in all states, not just those in Illinois. The plurality felt that this "sweeping extraterritorial effect" was too much.¹⁰¹

A majority of five justices reached agreement on the second commerce clause attack. The majority held that the burden on interstate commerce outweighed the local interests which the Illinois Act was designed to protect. The burden on interstate commerce was the Illinois Secretary of State's power to block a nationwide tender offer. According to the majority, the exercise of that power would deprive shareholders of the opportunity to sell their shares at a premium, hinder the reallocation of economic resources to their highest valued use, and reduce the incentive the tender offer mechanism provides incumbent management to perform well.¹⁰²

The Illinois Secretary of State argued that the Illinois Act furthered two legitimate local interests: first, it protected resident security holders; and second, it merely regulated the internal affairs of corporations incorporated under Illinois law. The Court rejected both of these claimed interests.¹⁰³

The Court recognized that protecting local investors is a legitimate state objective, but stated that Illinois had no legitimate interest in protecting nonresident shareholders. As to these nonresident shareholders, there was no countervailing state interest to sustain the law. The court also noted that the Illinois Act's exemption of a corporation's repurchases of its own shares was inconsistent with the shareholder protection rationale. The Court agreed with the court of appeals that the benefits to resident security holders were speculative at best since the Williams Act already provided many of the same substantive protections as the Illinois Act and "the possible benefits of the potential delays required by the Act may be outweighed by the increased risk that the tender offer will fail due to defensive tactics employed by incumbent management."¹⁰⁴

The Court also rejected the internal affairs justification for the Illinois Act. The Court argued that tender offers contemplate the transfer of shares from shareholders to a third party and therefore do not implicate the internal affairs of the target company. Even if they did, the Illinois Act applied to corporations not incorporated in Illinois

100. *Id.* at 642. For example, the Illinois Act would apply to an offer for the stock of a corporation which was incorporated in Illinois and had its principal executive offices in Illinois, even if it had no Illinois shareholders.

101. *Id.* at 642-43.

102. *Id.* at 643-44.

103. *Id.* at 644-46.

104. *Id.* at 645.

with principal places of business in other states; the Court held that "Illinois has no interest in regulating the internal affairs of foreign corporations."¹⁰⁵

A plurality of three justices would also have held that the Williams Act preempted the Illinois Act.¹⁰⁶ The Williams Act does not explicitly prohibit states from regulating takeovers. Therefore, according to the plurality, the Illinois Act was void only if (1) compliance with both the Illinois Act and the Williams Act was a physical impossibility, or (2) the Illinois Act stood " 'as an obstacle to the accomplishment . . . of the full purposes and objectives of Congress.' " ¹⁰⁷ No one contended that it would be impossible to comply with both the Illinois Act and the Williams Act,¹⁰⁸ so the plurality focused on the second test.

The plurality recognized that Congress' primary purpose in adopting the Williams Act was to protect investors. However, the plurality argued that "it is also crystal clear that a major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder."¹⁰⁹ According to the plurality, "[t]his policy of 'even-handedness' . . . represented a conviction that neither side in the contest should be extended additional advantages vis-a-vis the investor, who if furnished with adequate information would be in a position to make his own informed choice."¹¹⁰

The plurality identified three provisions of the Illinois Act that upset the careful balance struck by Congress between management and the offeror.¹¹¹ First, the Illinois Act required registration of the offer twenty days before the offer became effective. The plurality noted that Congress had considered and several times refused to include a precommencement disclosure requirement in the Williams Act and that "by providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers."¹¹² Second, the plurality found the hearing provisions of the Illinois Act, and the delays they might cause, objec-

105. *Id.* at 645-46.

106. *Id.* at 630-40.

107. *Id.* (quoting *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963)).

108. *Id.* at 631-32. Subsequent to MITE's tender offer, but before the Supreme Court's consideration of the case, the SEC adopted Rule 14d-2(b), 17 C.F.R. § 240.14d-2(b) (1988), requiring a tender offeror to begin its offer within five days after publicly announcing the material terms of the offer. Rule 14d-2(b) seems to directly conflict with the Illinois Act, but its effect was not considered by the Court because the rule operated only prospectively, and therefore did not apply to MITE's offer. *Edgar v. MITE Corp.*, 457 U.S. 624, 636 n.11 (1982).

109. *Edgar v. MITE Corp.* 457 U.S. 624, 633 (1982).

110. *Id.* at 633-34 (citation omitted).

111. *Id.* at 634-40.

112. *Id.* at 635.

tionable. The plurality noted that the ability to delay the offer until the conclusion of a fairness hearing could be used by incumbent management to seriously impede and stymie indefinitely a takeover. The plurality was particularly concerned about the ability of incumbent management to force the Secretary to hold a hearing. Third, the plurality was disturbed by the power of the Secretary of State to block an offer that the Secretary found to be substantively unfair. The plurality found this inconsistent with the congressional judgment in the Williams Act that investors should be free to make their own decisions. According to the plurality, Illinois was attempting to offer "investor protection at the expense of investor autonomy—an approach quite in conflict with that adopted by Congress."¹¹³

Justices Stevens and Powell refused to join in the plurality's preemption opinion. Each disagreed with the argument that the Williams Act's policy of neutrality implied a federal prohibition of state legislation designed to protect incumbent management.¹¹⁴

2. CTS Corp. v. Dynamics Corp. of America

The Supreme Court's only other consideration of a state statute restricting takeovers came in 1987 in *CTS Corp. v. Dynamics Corp. of America*,¹¹⁵ involving the Control Share Acquisitions Chapter¹¹⁶ of the Indiana Business Corporation Law. The Indiana Act applies to "issuing public corporations," which include only businesses incorporated in Indiana¹¹⁷ that have (1) 100 or more shareholders; (2) their principal place of business, principal office, or substantial assets within Indiana; and (3) either ten percent or more of their shareholders residing in Indiana, ten percent or more of their shares owned by Indiana residents, or 10,000 shareholders residing in Indiana.¹¹⁸

Under the Indiana Act, a person or entity acquiring "control shares" does not acquire the right to vote those shares for any purpose unless voting rights are approved by a majority vote of all disinterested shareholders of each class of voting stock.¹¹⁹ An entity acquires "control shares" whenever it acquires shares that, but for the operation of the Act, would increase its voting power to or above any of

113. *Id.* at 640 (quoting *MITE Corp. v. Dixon*, 633 F.2d 486, 494 (7th Cir. 1980)).

114. *Id.* at 646-47 (Powell, J., concurring in part); *Id.* at 654-55 (Stevens, J., concurring in part and concurring in the judgment).

115. 107 S. Ct. 1637 (1987).

116. IND. CODE §§ 23-1-42-1 to 23-1-42-11 (Supp. 1988).

117. *Id.* § 23-1-20-5.

118. *Id.* § 23-1-42-4(a). As in the Nebraska Shareholders' Protection Act, the residence of a shareholder is presumed to be the address appearing on the records of the corporation. *Compare id. with* NEB. REV. STAT. § 21-2432 (Cum. Supp. 1988).

119. IND. CODE § 23-1-42-9 (Supp. 1988). Unlike the Nebraska Act, the Indiana Act excludes the shares of officers and inside directors from voting in this election. *Compare id.* § 23-1-42-3(2), (3) *with* NEB. REV. STAT. § 21-2432 (Cum. Supp. 1988).

three thresholds: twenty percent, thirty-three and one-third percent, or fifty percent.¹²⁰ As in the Nebraska Act, an acquiring person can compel a special shareholders' meeting within fifty days by filing a disclosure statement.¹²¹ If no such statement is filed, the acquiring person's voting rights are considered at the next special or annual meeting. The Indiana Act also gives the corporation the right to redeem the control shares at their fair value if no disclosure statement is filed or if the shareholders do not approve full voting rights for the shares.¹²²

The United States District Court for the Northern District of Illinois held the Indiana statute preempted by the Williams Act and violative of the commerce clause;¹²³ the Seventh Circuit Court of Appeals affirmed, only to be reversed by the Supreme Court.

Justice Powell, writing for the majority, concluded that the Williams Act does not preempt the Indiana Act.¹²⁴ Noting that it was possible to comply with both the Williams Act and the Indiana Act, the Court reasoned that the Indiana Act was preempted only if it frustrated the purposes of the Williams Act. Claiming to apply the *MITE* plurality's preemption reasoning, the Court held that the Indiana Act did not frustrate the purposes of the Williams Act.¹²⁵

The Court believed that the Indiana statute, unlike the Illinois

120. IND. CODE § 23-1-42-1 (Supp. 1988).

121. *Id.* § 23-1-42-7.

122. *Id.* § 23-1-42-10.

123. *Dynamics Corp. of America v. CTS Corp.*, 637 F. Supp. 389 (N.D. Ill. 1986), *aff'd*, 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987).

124. Justice Scalia filed a concurring opinion agreeing that the Williams Act does not preempt the Indiana Act, but using a different rationale. Justice Scalia relied on section 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a) (1982), providing that nothing in the Exchange Act "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." Admitting that this provision might not literally apply to the Indiana Act because the Indiana Act was not within the province of the Indiana securities authority, Justice Scalia nevertheless felt that section 28(a) foreclosed preemption on the basis of a conflict of purpose. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1653 (1987) (Scalia, J., concurring in part and concurring in the judgment). According to Justice Scalia:

It would be peculiar to hold that Indiana could have pursued the purpose at issue here through its blue-sky laws, but cannot pursue it through the State's even more sacrosanct authority over the structure of domestic corporations. Prescribing voting rights for the governance of state-chartered companies is a traditional state function with which the Federal Congress has never, to my knowledge, intentionally interfered. I would require far more evidence than is available here to find implicit pre-emption of that function by a federal statute whose provisions concededly do not conflict with the state law.

Id.

125. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1645 (1987). The majority did not concede that the *MITE* preemption analysis was correct.

statute reviewed in *MITE*, did not favor incumbent management over offerors.¹²⁶ The Court saw the Indiana Act as protecting independent shareholders from the coercive aspects of some tender offers, particularly two-tier offers.¹²⁷ The Court felt that shareholders could use the Act's voting provisions to reject offers that individual shareholders might feel pressured to accept. The Court found this consistent with the basic policy of the Williams Act—protecting investors by placing them on an equal footing with the offeror.

The Court noted that the Indiana Act avoided the problems with the Illinois statute pointed out by the *MITE* plurality. The Indiana Act gives neither management nor the offeror an advantage in communicating with shareholders, it does not indefinitely delay tender offers, and it does not allow the state to impose its own view of fairness on the shareholders.

The court of appeals based its finding of preemption on its view that, since no offeror would want to acquire shares without voting rights, the Indiana Act forces a fifty-day delay between commencement of the offer and its conclusion and therefore conflicts with the SEC rule allowing an offer to close after twenty days.¹²⁸ The Supreme Court rejected this argument; the Indiana Act does not force the offeror to leave the offer open for more than twenty days; if the offeror wants voting rights, it can condition its offer on the approval of voting rights within a specified period.¹²⁹ Finally, the Court noted that the *MITE* plurality did not say that *any* delay would create a conflict with the Williams Act, only *unreasonable* delay. The Court did not consider a fifty-day delay unreasonable.¹³⁰ The Court pointed out other

126. *Id.* at 1645-46. The Court noted Dynamics' argument that the provision of the Indiana Act allowing management to opt into the Act during the first seventeen months after enactment gave management a potential strategic advantage because offerors would be reluctant to take the expensive preliminary steps of a tender offer if they did not know whether they would be subjected to the Act. However, the Court felt that the temporary nature of the opt-in provision rendered it of little significance. *Id.* at 1646 n.7. The Court also felt that the added expense imposed by the Indiana Act "does not alter the balance between management and offeror in any significant way." *Id.* According to the Court, "[i]f an offeror—who has no official position with the corporation—desires a special meeting, solely to discuss the voting rights of the offeror, it is not unreasonable to have the offeror pay for the meeting." *Id.*

127. *Id.* at 1646. See *infra* text accompanying notes 250-95.

128. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 263 (7th Cir. 1986); see 17 C.F.R. § 240.14e-1 (1988).

129. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1647 (1987).

130. *Id.* In a curious misreading of the Williams Act, the Court stated that "[t]his period is within the 60-day maximum period Congress established for tender offers in 15 U.S.C. Section 78n(d)(5)." Section 14(d)(5) of the Williams Act, 15 U.S.C. § 78n(d)(5) (1982), does not establish a maximum duration for tender offers, but merely provides that shareholders may withdraw tendered shares if the offer remains open for more than sixty days. Nothing in the Act prohibits an offeror

provisions of state corporate law, particularly classified boards¹³¹ and cumulative voting,¹³² which limit or delay the free exercise of control after a tender offer. The Court argued that, given "the longstanding prevalence of state regulation in this area," if Congress had intended to preempt all state laws delaying the acquisition of voting control after a tender offer, it would have done so expressly.¹³³

The Court also rejected the commerce clause challenge to the Indiana Act. According to the Court, the principal objects of dormant commerce clause scrutiny are state statutes that directly discriminate against interstate commerce. The Indiana Act is not directly discriminatory because it applies equally to all offerors, whether or not they are Indiana residents. The Court was unconcerned that most offerors are likely to be out-of-state entities, as long as the burden imposed on Indiana offerors and nonresident offerors is the same.

The Court noted that it had previously invalidated state statutes which adversely affected interstate commerce by subjecting activities to inconsistent regulation by more than one state. However, the Court felt that the Indiana Act posed no such problem. A state's authority to regulate the voting rights of domestic corporations is well-established, and "[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State."¹³⁴

The Court then turned to the final commerce clause challenge—the claim that the burden imposed by the Indiana Act on interstate commerce was excessive in relation to the putative local benefits of

from leaving the offer open for a longer period. The sixty-day period is no longer important even with respect to withdrawal rights. The SEC rules now allow withdrawal at any time during the offer. Rule 14d-7, 17 C.F.R. § 240.14d-7 (1988).

131. A board is "classified" when all of the directors do not stand for election each year. Instead, they are chosen for periods longer than one year with staggered terms of office. Only one class of directors is elected each year. See 2 W. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 334.1 (perm. ed. 1982); H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 556-57 (3d ed. 1983). The NBCA allows a Nebraska corporation to provide in its articles of incorporation for a classified board of directors. NEB. REV. STAT. § 21-2037 (1987). The corporation's directors may be divided into two or three equal classes of at least three directors each, with one class elected at each annual meeting on a rotating basis. *Id.*
132. Cumulative voting is a method of voting for corporate directors in which each shareholder may cast as many votes as he or she has shares multiplied by the number of directors to be elected. Each shareholder is permitted to concentrate or distribute the votes among the candidates as he sees fit. The purpose of cumulative voting is to promote minority shareholder representation on the board. See 5 W. FLETCHER, *supra* note 131, §§ 2048-2048.3; H. HENN & J. ALEXANDER, *supra* note 131, at 495-98. The Nebraska Constitution requires cumulative voting for Nebraska corporations. NEB. CONST. art. XII, § 1.
133. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1648 (1987).
134. *Id.* at 1649.

the statute.¹³⁵ The Court emphasized the traditionally recognized interest of a state in regulating corporations incorporated in that state and noted that such state laws necessarily affect interstate commerce where the corporation has nonresident shareholders. According to the Court, the interstate operation of a free market for capital “depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.”¹³⁶ State laws regulating domestic corporations may directly affect a variety of corporate transactions, but the state “has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.”¹³⁷ The Court found that the purpose of the Indiana Act—to protect the autonomy of the shareholders of Indiana corporations—was “well within the State’s role as overseer of corporate governance,” even as extended to nonresident shareholders of Indiana corporations.¹³⁸ According to the Court, *MITE* only held that a state has no interest in protecting nonresident shareholders of nonresident corporations. Moreover, unlike the Illinois statute at issue in *MITE*, the Indiana Act applies only to corporations with a substantial number of shareholders resident in Indiana, and the Court felt that Indiana indisputably had an interest in protecting those resident shareholders.¹³⁹

135. Justice Scalia, who concurred with the rest of the majority’s commerce clause analysis, refused to join in this portion of the Court’s opinion:

[The balancing required by this test] is ill suited to the judicial function and should be undertaken rarely if at all. . . . Nothing in the Constitution says that the protection of entrenched management is any less important a ‘putative local benefit’ than the protection of entrenched shareholders, and I do not know what qualifies us to make that judgment—or the related judgment as to how effective the present statute is in achieving one or the other objective—or the ultimate (and most ineffable) judgment as to whether, given importance-level *x*, and effectiveness-level *y*, the worth of the statute is ‘outweighed’ by impact-on-commerce *z*. . . . As long as a State’s corporation law governs only its own corporations and does not discriminate against out-of-state interests, it should survive this Court’s scrutiny under the Commerce Clause, whether it promotes shareholder welfare or industrial stagnation. Beyond that, it is for Congress to prescribe its invalidity.

Id. at 1652-53 (Scalia, J., concurring in part and concurring in the judgment).

136. *Id.* at 1650.

137. *Id.* at 1651.

138. *Id.* at 1651-52.

139. *Id.* at 1652. Professor Cox is probably correct when he characterizes this brief focus on the other contacts required by the Indiana Act as an “afterthought.” See Cox, *The Constitutional “Dynamics” of the Internal Affairs Rule—A Comment on CTS Corporation*, 13 J. CORP. L. 317, 350 n.173 (1988). The only lower courts to have considered the question agree with Professor Cox that the additional contacts required by the Indiana Act are not constitutionally required. *RP Acquisition Corp. v. Staley Continental, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 93,763, at 98,580

Dynamics argued that the prospect of coercive tender offers was illusory and that the Indiana Act would substantially limit the number of tender offers, thereby interfering with the efficient reallocation of corporate assets. The Court responded that the Constitution does not require the states to subscribe to any particular economic theory, and that it was not the Court's province to second-guess the state legislators' empirical judgments concerning the utility of the legislation.¹⁴⁰ Since the state created and defined corporations, it was not required to define them as other states did, as long as residents and nonresidents had equal access to them.

Justice White, who wrote the plurality opinion in *MITE*, found himself alone in arguing that the Williams Act preempted the Indiana Act.¹⁴¹ Justice White argued that the majority improperly equated the protection of individual investors, the focus of the Williams Act, with the protection of shareholders as a group. According to Justice White, the Williams Act was designed to promote individual investor autonomy, and the Indiana Act, which effectively allows a majority of the target corporation's shareholders to prevent a sale by any individual investor, conflicts with that individual autonomy. Justice White distinguished other corporate control provisions, such as cumulative voting and staggered boards, on the ground that the Indiana Act is transactional in nature, "designed to prevent certain tender offers from ever taking place."¹⁴²

Justice White's commerce clause dissent, joined by Justices Blackmun and Stevens, saw the Indiana Act as economic protectionism, designed to protect Indiana corporations. According to Justice White, the practical effect of the Indiana Act is to restrain the transfer of voting rights in interstate commerce. "A state law which permits a majority of an Indiana corporation's stockholders to prevent individual investors, including out-of-state stockholders, from selling their stock to an out-of-state tender offeror and thereby frustrate any transfer of corporate control, is the archetype of the kind of state law that the commerce clause forbids."¹⁴³

B. The Constitutionality of the Act's Regulation of Foreign Corporations

Senator Hartnett, who introduced the Nebraska Act, expressed

(D. Del. May 9, 1988); *Veere Inc. v. Firestone Tire & Rubber Co.*, 685 F. Supp. 1027, 1033 (N.D. Ohio 1988). *But see Fleet Aerospace Corp. v. Holderman*, 848 F.2d 720, 725 (6th Cir. 1988)(Kennedy, J., dissenting)(shareholders within the state are a "crucial requirement" for constitutionality).

140. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1651 (1987).

141. *Id.* at 1653 (White, J., dissenting). Justices Blackmun and Stevens joined only Justice White's commerce clause discussion.

142. *Id.* at 1655.

143. *Id.* at 1656.

complete confidence in its constitutionality.¹⁴⁴ The aide who helped draft the bill was more cautious, indicating that the definition of "issuing public corporation" was bifurcated to guarantee that the regulation of foreign corporations would be severable and would not affect the constitutionality of the rest of the bill.¹⁴⁵ This concern was appropriate because the Nebraska Act's regulation of foreign corporations is almost certainly unconstitutional.

The Supreme Court's approval of the Indiana Act in *CTS* was strongly grounded in the Indiana Act's limitation to Indiana corporations. The Supreme Court's evaluation of the possibility of inconsistent regulation focused heavily on the traditional internal affairs rule allowing states to regulate domestic corporations:

The Indiana Act poses no such problem. So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State. No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (1971) (concluding that the law of the incorporating State generally should 'determine the right of a shareholder to participate in the administration of the affairs of the corporation'). Accordingly, we conclude that the Indiana Act does not create an impermissible risk of inconsistent regulation by different States.¹⁴⁶

The Nebraska Act, on the other hand, does pose a risk of inconsistent regulation. The voting rights of shares of foreign corporations which meet the Nebraska Act's jurisdictional requirements would be governed by both the law of their state of incorporation and by Nebraska law. Given the Supreme Court's emphasis on a state's traditional authority to regulate the internal affairs of domestic corporations, it is clear which of the two potentially inconsistent regulations must fall—the Supreme Court would almost certainly support the "state's authority to regulate domestic corporations."¹⁴⁷ Justice Scalia's concurrence in *CTS* is equally limited; his opinion approves laws like the Indiana Act only "[a]s long as a State's corporation law governs only its own corporations."¹⁴⁸

The Nebraska Act's regulation of foreign corporations is also of questionable constitutionality under the *CTS* balancing analysis. The *CTS* majority noted that the national free market system for capital "depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its

144. In hearings before the Committee on Banking, Commerce & Insurance Senator Hartnett stated "[i]t is a legislation that we know will pass [sic] court tests of constitutionality." *Hearings, supra* note 35, at 51.

145. *Id.* at 104 (statement of Bill Stadtwald).

146. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1649 (1987).

147. *Id.*

148. *Id.* at 1653 (Scalia, J., concurring in part and concurring in the judgment).

incorporation."¹⁴⁹ Nebraska's exercise of jurisdiction over foreign corporations would upset the single-jurisdiction system of governance upon which the Court indicated the free market for capital was dependent.¹⁵⁰ *CTS* held that a state "has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs."¹⁵¹ The Court relied on a state's power to define the corporations that it creates. Nebraska has not created the foreign corporations covered by the Nebraska Act and *CTS*, therefore, does not give Nebraska the power to define the attributes of such corporations. Justice White's opinion in *MITE* expressly rejected the idea that a state has any interest in regulating the internal affairs of foreign corporations.¹⁵² Justice White found the internal affairs justification advanced by the Illinois Attorney General "somewhat incredi-

149. *Id.* at 1650.

150. Professor Buxbaum argues for a moderate reading of *CTS*'s state of incorporation passages. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29 (1987). Professor Buxbaum believes that the strongest scrutiny of potentially inconsistent state regulation should come only with respect to state laws, such as those regulating takeover bids, which have an impact on the interstate commerce implicit in stock market trading. *Id.* at 53-54. Although he recognizes a strong state-of-incorporation theme in *CTS*, he would limit it to state statutory responses to takeovers. He argues that the Court might allow regulation by another state if the number of resident shareholders in that other state and the local interests are strong enough. *Id.* at 54. Professor Buxbaum's conclusion might be correct but should not affect the analysis with respect to statutes affecting takeovers.

Professor Cox sees the two Supreme Court opinions as leaving the question even more open:

MITE Corp. and *CTS Corp.* established that the state of incorporation has a constitutionally legitimate interest in protecting nonresident shareholders of resident corporations and that a state has no legitimate interest in protecting nonresident shareholders of nonresident corporations. It is unknown whether a state has a legitimate interest in protecting resident shareholders of a nonresident corporation

Cox, *supra* note 139, at 355. Professor Cox argues that *CTS* and *MITE* may be read narrowly as not compelling the internal affairs rule, but concludes that the constitutional status of the internal affairs rule remains an implication of the two cases. *Id.* Professor Cox's open question is important, particularly as it relates to the scope of state blue sky laws, but it need not be answered in order to determine the constitutionality of the Nebraska Act. The Nebraska Act is of the type condemned in *MITE*—it regulates both resident and nonresident shareholders of nonresident corporations. The *CTS* majority agreed with Dynamics that a state has no interest in protecting nonresident shareholders of nonresident corporations. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1652 (1987).

151. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1651 (1987) (emphasis added).

152. According to the opinion, a state "has no interest in regulating the internal affairs of foreign corporations." *Edgar v. MITE Corp.*, 457 U.S. 624, 645-46 (emphasis added).

ble" as applied to foreign corporations.¹⁵³ This position was apparently accepted by the *CTS* majority as well; the Court distinguished *MITE* on the basis that the Illinois statute in *MITE* applied both to foreign and domestic corporations.¹⁵⁴ Thus, it is unlikely that Nebraska's regulation of foreign corporations will withstand constitutional scrutiny.

Lower court cases since *CTS* reaffirm this conclusion. Every federal court which has considered the issue has rejected extraterritorial state takeover statutes. *TLX Acquisition Corp. v. Telex Corp.*¹⁵⁵ involved the most analogous statute. The Oklahoma statute at issue in *TLX*¹⁵⁶ was similar to the Indiana Act approved in *CTS* except that the Oklahoma statute also applied to certain foreign corporations with Oklahoma contacts.¹⁵⁷ Telex, the target, was a Delaware corporation, but Oklahoma was Telex's principal place of business, and all of its officers, employees, and assets were located in Oklahoma.¹⁵⁸ Between ten and twenty percent of its shares were owned by Oklahoma residents.¹⁵⁹ The defendants argued that these substantial Oklahoma contacts gave Oklahoma a sufficient interest in regulating Telex; its state of incorporation was only "a legal technicality which is irrelevant."¹⁶⁰

The district court held that the Oklahoma statute violated the commerce clause because Oklahoma's regulation of the voting rights of foreign corporations posed an impermissible risk of inconsistent regulation.¹⁶¹ According to the Court, such inconsistent regulation might make it impossible for a tender offeror to know whether his shares would have voting rights, "bringing control-share acquisitions and tender offers to a sudden halt."¹⁶² The Court rejected the State's argument that there was no conflict because Delaware, the state of in-

153. *Id.* at 645.

154. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1652 (1987).

155. 679 F. Supp. 1022 (W.D. Okla. 1987).

156. Oklahoma Control Shares Acquisition Act, OKLA. STAT. ANN., tit. 18, §§ 1145 to 1155 (West Supp. 1988).

157. The Oklahoma Act applied to any corporation with 100 or more shareholders with its principal place of business, principal office, or substantial assets in Oklahoma, which met one or more of the following tests: (1) more than ten percent of its shareholders reside in Oklahoma; (2) more than ten percent of its shares are owned by Oklahoma residents; or (3) ten thousand or more of its shareholders reside in Oklahoma. *Id.* § 1148.

158. *TLX Acquisition Corp. v. Telex Corp.*, 679 F. Supp. 1022, 1029, 1025 n.6 (1987). This is somewhat misleading because the wholly-owned subsidiary which generated most of Telex's revenues operated worldwide. *Id.* at 1025 n.6.

159. *Id.* at 1029.

160. *Id.* at 1025 (emphasis added).

161. *Id.* at 1030. The court's decision was on a request for a preliminary injunction, so the court was only required to determine whether there was a substantial likelihood that the plaintiff offeror would prevail on the merits. However, the court held that "[p]laintiffs' success is certain." *Id.* at 1029 (emphasis added).

162. *Id.* at 1031.

corporation, had no comparable statute. In the Court's view, it was the risk, not the actual existence, of inconsistent regulation that created the commerce clause problem.

The Court rejected the argument that a state other than the state of incorporation might have a greater interest in regulating the voting rights of the corporation's shareholders. If that were so, the Court argued, the Supreme Court in *CTS* "would have found it necessary to determine whether some state other than Indiana . . . had a greater interest" in applying its law to *Dynamics*.¹⁶³ Since the Supreme Court did not undertake such a review, it must have intended to constitutionalize the internal affairs rule.

The district court also held, with little analysis, that the burden the Oklahoma Act imposed on interstate commerce exceeded its putative local benefits. The burden seen by the Court was the inhibitory effect the Oklahoma Act would have on nationwide tender offers because of the risk that the offeror would not gain voting rights. The Court recognized that Oklahoma had an interest in protecting resident shareholders and, arguably, in protecting the assets and business of corporations with all their assets or their principal place of business in Oklahoma. However, the Court saw no Oklahoma interest in protecting nonresident shareholders of foreign corporations or in regulating the internal affairs of those corporations.¹⁶⁴

*Campeau Corp. v. Federated Department Stores*¹⁶⁵ involved the Ohio Foreign Business Acquisitions Act,¹⁶⁶ which regulated takeovers of "resident" Ohio businesses by non-United States businesses. "Resident business" was defined to include foreign corporations with substantial contacts with Ohio.¹⁶⁷ The court held that the Ohio Act gave rise to an impermissible risk that a person would be subject to inconsistent regulation:

[M]any states could seek to regulate the acquisition of control of a national company, such as Federated, which has substantial assets and principal places

163. *Id.* at 1030.

164. *Id.* at 1032.

165. Fed. Sec. L. Rep. (CCH) ¶ 93,650 (S.D. Ohio Feb. 22, 1988).

166. OHIO REV. CODE § 1710.01-.05 (effective July 1, 1988, S.B. 359 Feb. 1988 Leg. Bull.).

167. To be included, a foreign corporation had to meet *all* of the following tests:

- (a) have assets in Ohio with a fair market value of at least five million dollars;
- (b) have more than five hundred employees in Ohio;
- (c) paid more than one million dollars in taxes to Ohio in its last fiscal year;
- (d) have its principal place of business or its principal executive office in and own or lease real estate in Ohio; and
- (e) prior to the commencement of the proposed acquisition of control, have more than ten percent and at least one thousand of its beneficial or record shareholders resident in Ohio.

Id. § 1710.01(B)(2).

of business in states other than Ohio. These other states would likely impose different requirements. Thus, the risk of inconsistent state regulations created by the Ohio Act, renders it invalid under the commerce clause.¹⁶⁸

No other lower court opinion since *CTS* has directly addressed the constitutionality of state takeover statutes regulating foreign corporations, but there is dictum in at least one other case indicating that extraterritorial application would be unconstitutional. The First Circuit Court of Appeals in *Hyde Park Partners, L.P. v. Connolly*¹⁶⁹ reviewed a Massachusetts statute that applied to offers for either Massachusetts corporations or foreign corporations with their principal place of business in Massachusetts.¹⁷⁰ The target in the case was a Massachusetts corporation, so the court did not review the statute's extraterritorial application, but the court indicated in dictum: "As to an out-of-state corporation, the statute would not likely survive commerce clause analysis under *CTS* because the corporation might be subject to regulations in both Massachusetts and its state of incorporation as to the same transaction."¹⁷¹

C. The Constitutionality of the Act as Applied to Nebraska Corporations

Even if the Nebraska Act's regulation of foreign corporations is unconstitutional, the Act contains a savings clause that would preserve the remainder of the statute.¹⁷² Thus, whether the Act is constitutional as applied to Nebraska corporations must also be considered.

168. *Campeau Corp. v. Federated Dep't Stores*, Fed. Sec. L. Rep. (CCH) ¶ 93,650, at 97,986 (S.D. Ohio Feb. 22, 1988). The court's argument is somewhat overstated, because a corporation could only have one principal place of business. If every state followed the Ohio formula, every corporation would be subject to regulation by at most two states—the state of incorporation and the state where the corporation has its principal place of business.

169. 839 F.2d 837 (1st Cir. 1988).

170. Massachusetts Take-Over Bid Regulation Act, MASS. GEN. L. ANN. ch. 110C, §§ 1-13 (West, Supp. 1988).

171. *Hyde Park Partners, L.P. v. Connolly*, 839 F.2d 837, 844 (1st Cir. 1988).

172. L.B. 1110, 90th Leg., 2d Sess. § 25 (1988). A possible state constitutional issue is raised if a court finds the Act unconstitutional as applied to foreign corporations but respects the savings clause and upholds its application to domestic corporations. The Nebraska Constitution provides that foreign corporations "shall not be given greater rights or privileges than are given domestic corporations of a similar character." NEB. CONST. art. XII, § 1. If the Nebraska Act is judicially limited to Nebraska corporations, one might argue that the resulting prohibition on business combinations with domestic corporations would violate this constitutional provision. The state constitutional argument against limiting the Act to domestic corporations seems unlikely to succeed. The only Nebraska case to consider article XII, § 1 held that it did not affect taxation and thus was inapplicable. *State v. Marsh*, 119 Neb. 197, 200, 227 N.W. 926, 927 (1929). The court implied in dictum that the constitutional prohibition would not preclude a state from requiring actions of domestic corporations not required of foreign corporations, especially where the state would not be permitted to so regulate foreign corporations. *Id.* Disallowing differential treatment of domestic and foreign corporations would fly

For discussion purposes, it is convenient to split the Act into its two constituent parts: first, the part of the Act affecting the voting rights of control shares; second, the part of the Act prohibiting business combinations with interested shareholders.

1. *The Voting Rights Limitation*

The voting rights portion of the Nebraska Act probably is constitutional because of its similarity to the Indiana Act upheld in *CTS*. In fact, in some ways the Nebraska Act is less restrictive than the Indiana Act. The Indiana Act takes away *all* voting rights from control shares, whereas the Nebraska Act gives control shares the right to elect directors without shareholder approval.¹⁷³ In addition, the Nebraska Act does not allow the corporation to redeem the control shares if they do not receive voting rights,¹⁷⁴ nor does the Nebraska Act give minority shareholders appraisal rights after a control-share acquisition, as does the Indiana Act.¹⁷⁵

The Nebraska Act is more restrictive than the Indiana Act in some ways, but these differences should not affect the constitutional analysis. First, it is much harder for a corporation to opt out of the Nebraska Act.¹⁷⁶ The Indiana Act allows a corporation to opt out of coverage at any time by an amendment to its articles of incorporation or bylaws.¹⁷⁷ The Nebraska Act, on the other hand, only allows an existing corporation to opt out of coverage within the first 45 days after the Act's effective date.¹⁷⁸ Since there is nothing in *CTS* which indicates that the Indiana Act's opt-out provisions were significant, this is unlikely to affect the Nebraska Act's constitutionality.¹⁷⁹ Second, the Nebraska Act grants full voting rights to control shares only if approved in the initial shareholder vote; the shareholders may not subsequently rescind a disapproving vote. The Indiana Act, on the

in the face of the long history of state corporation codes applicable only to domestic corporations.

173. Compare NEB. REV. STAT. § 21-2451 (Cum. Supp. 1988) with IND. CODE ANN. §§ 23-1-42-5, 23-1-42-9 (Supp. 1988).

174. See IND. CODE ANN. § 23-1-42-10 (Supp. 1988). One of the bills introduced in the Nebraska Legislature contained such a redemption provision. See L.B. 938, 90th Leg., 2d Sess. § 12 (1988).

175. See IND. CODE ANN. § 23-1-42-11 (Supp. 1988). This was also a feature of one of the bills introduced in the Nebraska Legislature. See L.B. 938, 90th Leg., 2d Sess. § 13 (1988).

176. Compare NEB. REV. STAT. § 21-2453(2), (3) (Cum. Supp. 1988) with IND. CODE ANN. § 23-1-42-5 (Supp. 1988).

177. IND. CODE ANN. § 23-1-42-5 (Supp. 1988).

178. NEB. REV. STAT. § 21-2453(2), (3) (Cum. Supp. 1988). See *supra* text accompanying notes 49-52.

179. See Cox, *supra* note 139, at 344-45 n.154 (arguing that an opt-out provision is probably not essential to constitutionality under *CTS* and that the statute would be constitutional even if mandatory).

other hand, arguably allows shareholders to change their minds after initially denying voting rights.¹⁸⁰ Again, there is no reason to believe that this would affect constitutionality. On balance, the voting rights portion of the Nebraska Act, as applied to Nebraska corporations, seems less restrictive than the statute approved in *CTS* and, therefore, would be constitutional.

2. *The Prohibition of Business Combinations*

The business combination part of the Nebraska Act presents greater constitutional difficulties. Its breadth and the inability of disinterested shareholders to override the ban cause serious preemption and commerce clause concerns. The Act would probably not survive under the analysis imposed by present case law.

a. *Preemption*

Indiana also has a prohibition against business combinations with interested persons,¹⁸¹ but that statute was not at issue in *CTS*, nor was it discussed. Four lower court cases have reviewed the constitutionality of business combination statutes since *CTS*. *BNS, Inc. v. Koppers Co.*,¹⁸² *RP Acquisition Corp. v. Staley Continental, Inc.*,¹⁸³ and *City Capitol Associates Limited Partnership v. Interco Inc.*¹⁸⁴ upheld the Delaware business combinations statute.¹⁸⁵ *RTE v. Mark IV Industries*¹⁸⁶ struck down the Wisconsin statute,¹⁸⁷ but was eventually vacated as moot.

The Delaware statute, which applies only to Delaware corporations, prohibits a variety of business combinations between a fifteen-percent shareholder and the corporation for a three-year period after the person becomes a fifteen-percent shareholder. There are three main ways around the ban. First, business combinations approved by the board before the person became an interested shareholder are not prohibited. Second, the ban does not apply if the person becomes an interested shareholder in an acquisition of at least eighty-five percent of the outstanding voting stock, excluding stock owned by officers and

180. See IND. CODE ANN. § 23-1-42-9 (Supp. 1988).

181. *Id.* §§ 23-1-43-1 to 23-1-43-15.

182. [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,730 (D. Del. Apr. 1, 1988).

183. [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,763 (D. Del. May 9, 1988).

184. Fed. Sec. L. Rep. (CCH) ¶ 94,079 (D. Del. Sept. 23, 1988). This opinion will not be discussed further because it merely adopts the reasoning of the other two Delaware cases.

185. DEL. CODE ANN. tit. 8, § 203 (1988).

186. No. 88-C-378 (E.D. Wis. May 6, 1988), *vacated as moot*, Fed. Sec. L. Rep. (CCH) ¶ 93,789 (E.D. Wis. June 22, 1988).

187. WIS. STAT. ANN. § 180.726 (West Cum. Supp. 1988).

certain employee stock ownership plans. Third, the interested shareholder may proceed with business combinations approved by the board *after* the person becomes an interested shareholder if the holders of two-thirds of the non-interested outstanding voting stock authorize the transaction. In addition, among other exceptions, the interested shareholder is freed from the ban when management approves a transaction with another person.

In *BNS*, the court's preemption analysis focused on the Delaware statute's interference with tender offers. The court rejected Delaware's argument that the statute was constitutional simply because it did not directly affect the tender offer process. According to the court, "[p]reventing states from unduly interfering with the tender offer itself but allowing them to deprive the tender offeror of perhaps the most important fruit of gaining control, i.e., a business combination, would permit a de facto frustration of the goals of the Williams Act."¹⁸⁸ Nevertheless, the court noted that even statutes which substantially deter tender offers do not circumvent Williams Act goals, "so long as hostile offers which are beneficial to target shareholders have a meaningful opportunity for success."¹⁸⁹ The court found that the three-year delay was not troublesome for preemption purposes since the use of staggered boards, implicitly approved in *CTS*, delays shifts of control for two years.¹⁹⁰ Further, although the Delaware statute tilts the balance in favor of management, it is still constitutional "so long as it does not prevent an appreciable number of hostile bidders from navigating the statutory exceptions."¹⁹¹

The court noted that the exceptions might place a substantial burden on would-be acquirors, but in the absence of hard evidence that the exceptions were illusory, the court was unwilling to upset the Delaware legislature's judgment. According to the court:

The legislature's judgment is that those escapes, together with the exceptions specified in subsection (b), allow offers beneficial to shareholders to proceed, and thus save the statute from constitutional infirmity.

. . . .

. . . [B]ecause the legislature presumably has balanced the countervailing effects and found the degree of stockholder protection to offset potential harm to stockholders, the Court concludes that the statute will be in all likelihood constitutional and not preempted. If the method Delaware has chosen to protect stockholders in fact on balance harms them, then at that time reconsider-

188. *BNS, Inc. v. Koppers Co.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 93,730, at 98,401 (D. Del. Apr. 1, 1988).

189. *Id.*

190. *Id.* at 98,402.

191. *Id.* Given the court's prior determination that the three-year delay did not create preemption problems, it is unclear why the exceptions matter at all. If the three-year delay is itself consistent with the Williams Act, it should not matter whether some offerors can use the exceptions to complete business combinations even sooner.

ation of the statute's congruence with the Williams Act will be warranted.¹⁹²

The preemption analysis in *RP Acquisition* was similar. The court noted the conflict between the statute's protection of independent shareholders and its deterrence of tender offers. According to the court, the statute protects shareholders by discouraging coercive two-tier tender offers or "all holders" offers followed by a freezeout of nontendering shareholders.¹⁹³ On the other hand, the statute could prevent a potential acquiror from quickly realizing synergistic gains and could make it more difficult for a highly leveraged offeror to borrow funds to finance the offer.¹⁹⁴ However, the court found that the eighty-five percent ownership exception was sufficient to save the statute from constitutional attack: "Certainly, Section 203 can be characterized as a good faith effort by the General Assembly to comply with the Constitution and specifically with the *CTS* decision. Given our independent analysis of the 85 percent exception, we discern no reason to disturb the balance the General Assembly struck."¹⁹⁵

The Wisconsin statute imposes an absolute three-year ban on business combinations between an interested shareholder and the corporation unless the combination is approved by the board of directors prior to the interested shareholder's share acquisition date.¹⁹⁶ After three years, such business combinations are allowed if approved by a majority vote of the disinterested shareholders or the combination passes a multifaceted fair value test.¹⁹⁷ In a brief opinion, the *RTE* court held the Wisconsin law incompatible with the Williams Act's purpose of promoting investor choice with respect to tender offers: "The Wisconsin act does not promote investor choice and instead gives to the management of target companies a virtual veto power over the outcome of a tender offer contest. The Wisconsin statute is the kind of parochial economic protectionism that cannot stand."¹⁹⁸

These cases create significant preemption problems for the Nebraska Act. The Nebraska Act is even less compatible with investor choice than the Wisconsin statute because the Nebraska prohibition lasts longer. As in the Wisconsin statute, the Nebraska Act gives target management the only real power to circumvent the ban, and thus provides management with strong control over the outcome of tender

192. *Id.* at 98,403.

193. *RP Acquisition Corp. v. Staley Continental, Inc.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 93,763, at 98,575 (D. Del. May 9, 1988).

194. *Id.*

195. *Id.* at 98,578.

196. WIS. STAT. ANN. § 180.726(2) (West Cum. Supp. 1988).

197. *See id.* § 180.726(3). Such combinations also are allowed after three years if the board of directors approved the interested shareholder's acquisition of stock in advance of the acquisition.

198. *RTE v. Mark IV Indus.*, No. 88-C-378 (E.D. Wis. May 6, 1988), *vacated as moot*, Fed. Sec. L. Rep. (CCH) ¶ 93,789 (E.D. Wis. June 22, 1988).

offers. Management might even use the prohibition on business combinations to defend against tender offers supported by *all* of the shareholders. The shareholders might elect a new board in such a case but, because timing is often crucial in takeovers, such a change might come too late. The Nebraska Act also does not contain any of the statutory exceptions for shareholder approval which the Delaware courts found arguably allowed offers beneficial to shareholders to proceed. Because there are no exceptions, the Nebraska Act would, in the words of *BNS*, "permit a de facto frustration of the goals of the Williams Act."¹⁹⁹ Thus, assuming the preemption analysis of these lower court cases is correct, the Nebraska Act probably is preempted by the Williams Act.

b. Commerce Clause

The Wisconsin case did not discuss the commerce clause challenge, but both Delaware cases did, following the three-part analysis set forth in *CTS*. Both cases recognized that the Delaware statute does not discriminate against out-of-state offerors, and that it does not subject interstate activities to possibly inconsistent regulations since it regulates only Delaware corporations.²⁰⁰

The two courts differed on the third test to be applied. The court in *BNS* saw the third test as whether the statute "promote[s] stable corporate relationships and protect[s] shareholders."²⁰¹ The court believed that it did. The *RP Acquisition* opinion seemed understandably confused about the third part of the *CTS* test. Noting that the full-scale balancing test used in *Pike v. Bruce Church, Inc.*²⁰² was seemingly abandoned by *CTS* in cases where the state only regulates intra-state corporate governance, the court nevertheless believed that the Supreme Court was engaged in some sort of deferential balancing; otherwise, its opinion would have ceased after discussing discrimination and inconsistent regulation. Thus, the court in *RP Acquisition* felt a need to weigh the benefits of the statute against its effect on interstate commerce. The court found *CTS* determinative. The Delaware statute, like the Indiana statute, applies only to domestic corporations and serves the purpose of preventing the Delaware corporate form from becoming a shield for unfair business dealings.²⁰³ On the burden side of the analysis, the court noted that given the exceptions

199. *BNS, Inc. v. Koppers Co.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 98,724, at 98,401 (D. Del. April 1, 1988).

200. *Id.* at 98,404. *RP Acquisition Corp. v. Staley Continental, Inc.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 93,763, at 98,579 (D. Del. May 9, 1988).

201. *BNS, Inc. v. Koppers Corp.* [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 93,730, at 98,404 (D. Del. April 1, 1988).

202. 397 U.S. 137 (1970).

203. *RP Acquisition Corp. v. Staley Continental, Inc.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 98,763, at 98,580 (D. Del. May 9, 1988).

to the Delaware ban on business combinations, the plaintiff had failed to prove that the Delaware statute would be any more restrictive of tender offers than the Indiana Act.²⁰⁴

Applying this commerce clause analysis to the Nebraska Act is difficult. The Act does not directly discriminate against out-of-state offerors and, as limited to Nebraska corporations, there is no danger of inconsistent regulation. But the balancing test creates problems. *BNS* asks only whether the statute promotes stable corporate relationships and protects shareholders. If one accepts the argument that two-tier takeovers are coercive and harmful to shareholders (as the Supreme Court did in *CTS*), the Nebraska Act's five-year ban on business combinations, which deters such takeovers, protects shareholders. The Nebraska Act, therefore, would pass the *BNS* commerce clause test.

The court in *RP Acquisition* purported to balance the statute's costs and benefits, albeit quite deferentially. The Nebraska Act might limit the number of tender offers for covered corporations, but the court correctly read *CTS* as saying that such a deterrent effect does not by itself make a state statute unconstitutional. The court hinted that the statute would be unconstitutional if the plaintiff could prove that it "virtually precludes all hostile tender offers, and thereby burdens interstate commerce in the extreme."²⁰⁵ The court, referring to its discussion of the statutory exceptions, held that the plaintiff had failed to prove that. However, it might be easier for a plaintiff to show that the Nebraska Act, with no major exceptions, precludes most tender offers.

It is at least arguable that *CTS* defers absolutely to state corporation laws, absent some discrimination against interstate commerce.²⁰⁶ Unlike *MITE*, *CTS* did not explicitly balance the Indiana Act's putative benefits against its impact on interstate commerce.²⁰⁷ *CTS* did not cite *Pike*, and the only reference to balancing is a quotation from *MITE* rejecting a state's interest in regulating out-of-state corporations.²⁰⁸ Justice Scalia's concurrence suggests that he believed the majority was engaged in some sort of balancing,²⁰⁹ but the majority never explicitly balanced. Professor Cox argues that the majority merely "pays lip service" to the balancing test and that the case "is

204. *Id.*

205. *Id.*

206. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America*, 101 HARV. L. REV. 96, 100-03; Cox, *supra* note 139, at 360-61.

207. For good discussions of the *CTS* Court's treatment of the balancing test, see Langevoort, *supra* note 206, at 100-01, 104-10; Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1864, 1866-68 (1987).

208. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1651 (1987).

209. *See supra* note 135.

properly viewed as undermining, if not abandoning, the notion that the dormant commerce clause requires a balancing analysis."²¹⁰ Professors Regan and Langevoort, although they do not agree as to what the majority is doing in *CTS*, both concur that no balancing is involved.²¹¹ A state is free to define the corporate entities it creates as it feels wise, as long as it regulates only its own corporations, and whether or not such laws decrease tender offers is irrelevant to commerce clause analysis. As Professor Cox argues, "[t]he fundamental point made by the Court's opinion in *CTS Corp.* is that the wisdom of the Indiana Control Shares Statute is an irrelevancy for constitutional purposes."²¹² Assuming this view is correct, the Nebraska Act's five-year prohibition of business combinations, as limited to Nebraska corporations, probably survives the commerce clause challenge. However, a recent Supreme Court case casts doubt on these conclusions. In *Bendix Autolite Corp. v. Midwesco Enterprises, Inc.*,²¹³ the Court considered a challenge to an Ohio statute that tolled the statute of limitations against foreign corporations which had not appointed an Ohio agent for service of process. The Court overturned the statute after expressly balancing the local interest advanced by the statute against the burden imposed on interstate commerce.²¹⁴ However, the Court's only reference to *CTS* was in discussing direct discrimination and inconsistent regulation.²¹⁵ It is therefore unclear whether the *Bendix* opinion recognizes state corporation statutes as being subject to a full balancing test.

c. *Legislative Purpose*

One might argue that the Nebraska Act, even if otherwise permis-

210. Cox, *supra* note 139, at 357, 360-61.

211. See Langevoort, *supra* note 206, at 100-01; Regan, *supra* note 207, at 1866-68. Langevoort hypothesizes that one reason the Court refused to engage in balancing may be that there was no evidentiary record on the effects of the statute or its motivation, leaving a later court free to distinguish *CTS* if the plaintiff presents a compelling factual showing on these questions. Langevoort, *supra* note 206, at 103 n.45. Langevoort also believes that balancing would have raised exceedingly difficult questions of federalism in corporate law:

The Court saw before it a disturbingly slippery slope: if it mandated a balancing approach simply because of the extraterritorial effects of the statute, it would open up all corporate law principles to similar challenge. Subjecting all of corporate law to such a balancing test would be an imposing task at best. . . . The effort would hardly be appealing to a Court committed to maintaining a separation between the federal and state spheres of influence in matters of corporate law.

Id. at 106.

212. Cox, *supra* note 139, at 362.

213. 108 S. Ct. 2218 (1988).

214. *Id.* at 2220-23. Justice Scalia again strongly disagreed with the Court's use of a balancing test. *Id.* at 2223-24 (Scalia, J., concurring in the judgment).

215. *Id.* at 2222.

sible, is unconstitutional because it was adopted for an impermissible purpose—to prevent the movement of assets and jobs from Nebraska to other states.²¹⁶ Professor Regan sees the *CTS* discrimination analysis as focusing on the purpose of the statute rather than its effect.²¹⁷ According to Professor Regan, if the Indiana legislature's sole purpose was to prevent the removal of corporate operations from Indiana, the statute would violate the commerce clause.²¹⁸ The Indiana Act's requirement of additional contacts with Indiana other than incorporation in Indiana strongly supports the argument that Indiana was motivated by a desire to prevent corporate relocations to other states. If Indiana's concern was solely to protect the shareholders of Indiana corporations, these further requirements would be unnecessary.²¹⁹ The additional contacts required by the statute suggest that "Indiana sought to reward incumbent managements that agreed to engage in significant economic activity within Indiana by protecting them from offerors identifiable with economic activity outside the state."²²⁰ However, the majority opinion in *CTS* focused on the burden of the statute rather than the legislative motivation underlying it: "Because nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce."²²¹ Although Professor Regan's reading of the words "similarly situated" is ingenious,²²² this passage clearly focuses on the effect of the statute. The *CTS* majority did not examine the possible purpose of advantaging local workers and suppliers. The only court to have considered the question with respect to an antitakeover statute concluded that legislative motive was irrelevant.²²³ Thus, if one of the

216. *Hearings, supra* note 35, at 48. (Statement of Sen. Hartnett) ("This bill is just one of more provisions to encourage businesses that are looking at Nebraska to locate . . . here"). Actually, there is little expression in the legislative record of purely protectionist motives, although an undercurrent of protectionist sentiment pervades the legislative discussions of the attempts to take over Goodyear and Enron. See *infra* text accompanying notes 327-33.

217. Regan, *supra* note 207, at 1869-73.

218. *Id.* at 1871-72. See also Comment, *Beyond CTS: A Limited Defense of State Tender Offer Disclosure Requirements*, 54 U. CHI. L. REV. 657, 675 (1987) ("While it is no doubt in a state's interest to keep within its borders the economic and intangible benefits that responsible corporations provide, such protectionism seems to be precisely what the commerce clause was intended to prevent").

219. Langevoort, *supra* note 206, at 106-07; Cox, *supra* note 139, at 341-42.

220. Cox, *supra* note 139, at 342.

221. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1649 (1987).

222. See Regan, *supra* note 207, at 1870.

223. *BNS, Inc. v. Koppers Co.*, [1987-1988 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 93,730, at 98,404 (D. Del. April 1, 1988). ("Indications that the stated purpose of the statute may not wholly conform with the legislature's true motives, however strong, must be ignored where the statute does accomplish the stated purpose."). The court found the legislative history of the Delaware statute to be mixed, focus-

Nebraska Legislature's motives was to keep businesses in Nebraska, this would not in and of itself render the Nebraska Act unconstitutional.

V. IS THE ACT GOOD POLICY?

The Nebraska Act is designed to chill hostile takeovers in two ways. The control-share provision is designed to make it easier for target management and shareholders to defend against hostile takeovers, primarily by giving them more time to react and by placing an additional cost on tender offers. Both the control-share provision and the business combination provision are designed to make the prize—control of the target company—less valuable to the bidder. They limit what a successful bidder may do with the corporate assets. The Legislature's adoption of the Act was premised on a belief that hostile corporate takeovers are bad—for the target shareholders, for the state, and for the nation's economy. This section begins with a review of the purported benefits of hostile tender offers, followed by a review of the major arguments made in opposition to hostile tender offers and in favor of the Nebraska Act. This analysis shows that most of the arguments against allowing a free market for hostile takeovers are wrong. Furthermore, the Nebraska Act does little to correct the purported abuses pointed to by the critics.

A. The Arguments for Takeovers

1. *Disciplining Inefficient Management*

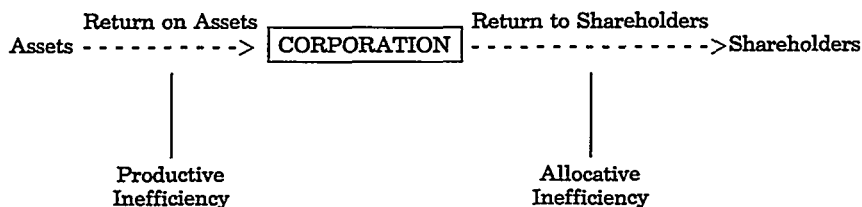
One of the benefits of hostile takeovers is that they give target shareholders a way to discipline and control the management of the target corporation in situations where other control mechanisms fail. To understand this point, it is first necessary to briefly review the problem of managerial inefficiency and why other controls on such inefficiency do not always work.

The opportunities for managerial inefficiency fall into two categories,²²⁴ which will be called productive inefficiency and allocative inefficiency. The residual return ultimately going to a corporation's shareholders can be visualized as a two-part path (See Figure A.). The first part of the path represents the economic return on the corporation's assets, after paying all costs economically associated with producing that income. The second part of the path represents how much of that return actually benefits the shareholders, either in the form of

ing both on shareholder welfare and on the possible losses of corporate franchise taxes and fees to other states. *Id.* ¶ 98,404 n.31.

224. This categorization, but not the terminology, appears in Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 836-40 (1981).

FIGURE A



dividends or retained earnings. Productive inefficiency is a failure to maximize the first path—a failure to achieve the best possible return in the product market on the corporation's assets. Allocative inefficiency is a failure to maximize the second path. Allocative inefficiency does not involve a below-market return on the corporation's assets. The assets might earn as high a rate of return as they could if deployed by any other management, but a portion of that return is diverted to management and not shared with the shareholders. Management may deal with the corporation in an unfair manner (self-dealing), may provide itself luxurious perquisites, or may pay itself above-market compensation.²²⁵ Allocative inefficiency gives managers a noncompetitive return for their services and confiscates value that might otherwise go to the shareholders. Management has an incentive to engage in such allocative inefficiency because management does not fully share in the returns to shareholders but receives the full benefit of such diversions.

Both forms of managerial inefficiency reduce the return to shareholders and thereby reduce the value of shareholders' investments. The possibility of a hostile takeover helps shareholders to control such inefficiency.²²⁶ Either form of inefficiency causes the price of the corporation's stock to fall. This creates an opportunity for entrepreneurial profit. An outsider could purchase a controlling interest in the corporation at this reduced market price, or at some premium price between the depressed market price and the stock's value with

225. Ordinary, competitive benefits and compensation to management are part of the cost of producing the income and are, therefore, legitimate deductions from gross economic income in determining the size of the first stream. It is only the payment of compensation in excess of the market value of the manager's services that constitutes allocative inefficiency. The model admittedly leads to some categorization difficulties, but it is nevertheless adequate to convey the idea that managerial inefficiency is not merely suboptimal productive performance.

226. Many authors have discussed the disciplinary effects of hostile takeovers. The seminal work is Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). See also Gilson, *supra* note 224, at 841-845; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1173-74 (1981); Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1163-66 (1984).

efficient management, and use the resulting control of the corporation to install new, more efficient managers. The additional return earned by the corporation under these more efficient managers would increase the price of the corporation's stock, producing a profit for the takeover entrepreneur.²²⁷

This process tends to move corporate assets from the hands of less efficient managers into the hands of more efficient managers. Even shareholders whose corporation is not subject to a bid are benefitted by the general deterrent effect of hostile takeovers. Managerial inefficiency is constrained by the threat that a hostile takeover could occur and managers would lose their jobs.²²⁸

Obviously, the hostile takeover does not prevent all managerial inefficiency. As Professor Coffee points out, the tender offer operates as a disciplinary mechanism only within a limited range of inefficient companies:

Basically, this range is bounded, on the one end, by the bidder's level of risk aversion and, on the other, by the minimum premium necessary to acquire control. Companies in which the level of inefficiency is either not extreme enough to justify the necessary premium or so extreme as to surpass the bidder's level of risk aversion fall outside this range and may therefore be only weakly disciplined by the market for corporate control.²²⁹

Many minor instances of managerial inefficiency or self-dealing will not produce a significant enough discount in the company's stock price to justify the substantial premiums being offered. However, it is clear that hostile takeovers have at least some beneficial deterrent effect on management inefficiency. The full extent of that deterrent effect cannot be quantified. There is no way to measure the extent to which the threat of a hostile takeover causes management to modify

227. Professor Lowenstein questions the efficient market hypothesis upon which this analysis is based. Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 268-306 (1983). Lowenstein's views on the efficiency of the stock markets are not shared by most scholars. See, e.g., R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 156-57 (1986) (the efficient capital market hypothesis has been the leading success story of modern finance theory); Jensen, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95, 96 (1978) ("there is no other proposition in economics which has more empirical evidence supporting it than the efficient market hypothesis"). Lowenstein's reliance on accounting data, such as reported earnings, renders his analysis suspect. Such data is easily manipulated by a corporation's management and, because of its reliance on historical cost, often does not reflect true economic values and returns. See, e.g., R. GILSON, *supra*, at 382. For an excellent criticism of the view that the market is inefficient, see Coffee, *supra* note 226, at 1170-73. Professor Coffee points out that even if the inefficient market view is correct, takeovers still will be beneficial in curbing managerial inefficiency. *Id.* at 1171-73.

228. Coffee, *supra* note 226, at 1192.

229. *Id.* at 1204.

its behavior; only the cases where hostile tender offers actually occur can be observed.

Even if hostile takeovers effectively discipline management, however, they are desirable only if less expensive and equally effective controls on managerial inefficiency are not available. There are several other mechanisms that might control managerial inefficiency. These include the shareholder's power to replace the directors, the use of outside monitors, litigation asserting violations of fiduciary duty, compensation schemes, competition in the market for the company's products, and competition in the market for managerial services. A close analysis of each of these other mechanisms reveals that none effectively checks management inefficiency. Thus, the hostile takeover is a necessary device to protect shareholders.

The primary problem with the election process is the lack of shareholder incentives to adequately monitor management.²³⁰ It is expensive to monitor management performance, and no single shareholder receives most of the gains from monitoring. The cost for a particular shareholder to monitor the corporation's performance often exceeds the gain to be expected from changing management when inefficiency is discovered, even assuming for the sake of argument that such a change of management would be costless. It is usually in the shareholder's self-interest to forego monitoring and simply sell his shares if he is dissatisfied with management's performance.

Assume, nevertheless, that an individual made the investment necessary to monitor and detect managerial inefficiency. How is that shareholder to use the election process to stop the inefficiency and force value-maximizing behavior? A shareholder attempting to do anything about inefficient management once it is discovered faces the same collective action problem that inhibits discovery of such behavior in the first place. The other shareholders would be persuaded to oust existing management only if they too were convinced of the inefficiency, and they would have to invest a significant amount of time to study the corporation's performance. The cost of examining the dissident shareholder's claims, like the cost of monitoring, is likely to exceed the possible benefit to each shareholder of a change in management. Each shareholder will recognize that he cannot affect the outcome of the election and, therefore, will not invest in the cost of judging the corporation's performance, freeriding instead on the efforts of others. Each shareholder's self-interest thus leads him to ignore the dissident's claims and to side with existing management by default.

In addition, existing management's control of the proxy machinery and its ability to use corporate funds to support its goals stack the deck

230. Easterbrook & Fischel, *supra* note 226, at 1171.

against dissident shareholders. The dissident must pay for the fight himself and will limit expenses to the discounted expected gain from a change of control. Management, however, is basically free to bombard the shareholders with pro-management material at corporate expense.²³¹ It is not surprising that dissidents seldom win proxy fights.²³²

Shareholders might respond to the freeriding problem by establishing a separate mechanism to monitor management so that no single shareholder bears the expense. However, as Professor Gilson points out, "hiring yet another team of monitors merely recreates the problem one level removed."²³³ In theory, this is the traditional function of the board of directors. The shareholders elect the directors to oversee the performance of the corporation and correct any inefficiencies. Boards have been notoriously unsuccessful in performing this monitoring function, partially because of management's cooptation of the board through control of the proxy machinery.²³⁴ In practice, it is management, and not the shareholders, that selects the board, and one can hardly expect vigilant monitoring when the monitor is chosen by the monitored.

Litigation is another alternative for a shareholder seeking to stop managerial inefficiency, but litigation is unlikely to help. Courts traditionally have been reluctant to supervise productive inefficiency, invoking the business judgment rule to protect management from all but the most egregious mismanagement. Although some courts have toughened their duty of care review recently, the most that such cases seem to require is an adequate paper trail supporting management decisions.²³⁵ These recent cases do not adequately protect shareholders from informed incompetence. Courts also have been reluctant to in-

231. See, e.g., *Levin v. Metro-Goldwyn-Mayer, Inc.*, 264 F. Supp. 797 (S.D.N.Y. 1967); *Lock Manufacturing Cos. v. United States*, 237 F. Supp. 80 (D. Conn. 1964); *Rosenfield v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 (1955). See generally W. FLETCHER, *supra* note 131, § 2052.3 (discussing the general rule that the board of directors may send out proxies at the expense of the corporation and the pro-management implications of the rule).

232. The Nebraska Act does not recognize these disparities but rather reinforces them. An acquiring person seeking control must endure a special meeting and undoubtedly a proxy fight to obtain full voting rights or to obtain advance approval of a planned business combination.

233. Gilson, *supra* note 224, at 835. As Alchian and Demsetz ask, "who will monitor the monitor?" Alchian & Demsetz, *Production, Information Costs and Economic Organization*, 62 AM. ECON. REV. 777, 782 (1972).

234. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 139-48 (1976); Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 403, 464-65 (1980). But see Coffee, *supra* note 226, at 1202-03 (arguing that a "minimally independent board" would replace inefficient management before a hostile bidder could detect or respond to the inefficiency).

235. See *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985).

terfere with at least one form of allocative inefficiency—the amount of compensation going to managers.²³⁶ Courts have been more willing to review other forms of allocative inefficiency such as self-dealing and the taking of corporate opportunities, but these are only the most blatant forms of allocative inefficiency, and the limitations imposed on managers by the self-dealing rules still leave great latitude for inefficiency.

Martin Lipton argues that the rise of institutional investors makes these traditional mechanisms of corporate governance more effective.²³⁷ He argues that institutional investors possess both a significant stake in corporate governance, because of the size of their holdings, and the skills necessary to assert their influence. The size of the institutional investor's holdings increases the benefits of intervention, but it is still generally in the institutional investor's best interest to sell rather than to work for change through the voting process. Incumbent management's control of the proxy machinery poses substantial obstacles even to institutional investors.²³⁸ The other investors whom the institutional investors would have to persuade to throw out the incumbents would still have no incentive to invest their time and money to evaluate the competing claims. Thus, the presence of institutional investors may lessen the problems of shareholder action, but those problems are not eliminated. Even a large institutional investor is still dealing with a deck stacked against it.²³⁹

Shareholders might also try to control management by carefully structuring management's compensation to provide incentives for efficient performance. Managers can be given bonuses, stock options, and other incentive plans pegged to the performance of the corporation. Such devices help bring managerial incentives closer to shareholders' interests, but they are imperfect. For one thing, they do little to con-

236. See, e.g., *Broski v. Jones*, 614 S.W.2d 300 (Mo. Ct. App. 1981); *Heller v. Boylan*, 262 A.D. 1020, 29 N.Y.S.2d 653 (N.Y. Sup. Ct. 1941); *Murrell v. Elder-Beerman Stores Corp.*, 16 Ohio Misc. 1, 239 N.E.2d 248 (1968). Courts have been more willing to review executive compensation and perquisites in close corporations, recognizing that such compensation can be used in lieu of dividends to reward the controlling shareholders and freeze out the other shareholders. See, e.g., *Wilderman v. Wilderman*, 315 A.2d 610 (Del. Ch. 1974); *Newton v. Hornblower, Inc.*, 224 Kan. 506, 582 P.2d 1136 (1978); *Lynch v. Patterson*, 701 P.2d 1126 (Wyo. 1985). However, the problems of shareholder coordination and incentives to monitor are less extreme in close corporations.

237. Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 67-69 (1987).

238. Lipton apparently recognizes this problem because he supports an amendment to the federal securities laws to make the corporation's proxy machinery more accessible to large shareholders. *Id.* at 67-68.

239. In fact, the institutional investor may be even more likely to bail out without a fight than other shareholders. See LIVINGSTON, *THE AMERICAN SHAREHOLDER* 60-67 (1958).

trol allocative inefficiency. Incentive compensation plans give managers some portion of every dollar gained by reducing allocative inefficiency, but, unless managers get 100 percent of the gains, it is always in management's self-interest to continue to receive the benefits of allocative inefficiency. Every additional dollar of return to the shareholders resulting from increased allocative efficiency is a dollar out of management's pocket. If such plans do give managers all or almost all of the gains, then the incentive compensation contract merely sanctions the preexisting allocative inefficiency; it results in no true gains to shareholders.

Compensation plans are also imperfect in stopping productive inefficiency. Such plans depend on the firm's ability to determine the marginal contribution of each manager to the overall performance of the firm.²⁴⁰ It is difficult, if not impossible, to determine an individual manager's effect on the performance of a large enterprise. In addition, because the gains of increased performance go at least in part to the shareholders, managers will not find it in their self-interest to fully monitor each other.²⁴¹

Competition in the product and managerial labor markets is also an inadequate control on management. Competition in the markets for the corporation's products will penalize a company with inefficient management.²⁴² Ultimately, in a perfectly competitive market, an inefficient corporation would be unable to keep up with its competitors and would fail. Management would lose their jobs. One would expect this possibility to constrain significant inefficiency. However, because most product markets are not perfectly competitive, it is possible for a corporation to survive despite some management inefficiency. The product market only insures that the most inefficient companies will go out of business. Moderate productive inefficiency will not be deterred. Even if competition in the product market forces out inefficient companies, this is slight comfort to shareholders whose investments are lost. Shareholders need a mechanism to promote efficiency before they lose their investments. Also, product market competition is unlikely to constrain allocative inefficiency. Allocative efficiency is solely a question of who receives the income and does not involve a suboptimal return on the corporation's assets. A corporation can compete successfully in the product market despite allocative inefficiency.²⁴³

The market for managers is another potential constraint on managerial inefficiency.²⁴⁴ The corporation's performance is commonly

240. Easterbrook & Fischel, *supra* note 226, at 1172.

241. *Id.* at 1172-73.

242. Gilson, *supra* note 224, at 837.

243. *Id.*

244. *Id.* at 837-40.

treated as a measure of managerial skills; corporate performance thus affects a manager's mobility and future compensation. Managers will want to increase the return to the corporation in order to increase the future value of their own services. However, the disciplinary effect of the managerial market is limited. First, managers will be worried about the market for their future services only to the extent that they anticipate leaving their present positions. If there is no mechanism to force them out of their current jobs, competition in the market for managerial services adds little additional incentive. Second, as Professor Gilson has pointed out, "[t]he buyers of managers for public corporations are, realistically, other managers."²⁴⁵ Even if the market for managers penalizes productive inefficiency, other managers have little incentive to penalize allocative inefficiency. High pay and perquisites are likely to be seen by these other managers as part of the game. A manager may also find that the discounted expected value of the future loss of compensation due to labor market discipline is less than the present value of the compensation diverted from the corporation's shareholders.

The failure of these other control mechanisms makes the tender offer extremely important in protecting shareholders from management inefficiency. The Nebraska Act, therefore, bears the burden of showing that the obstructions it places in the way of tender offers are worth the cost. The Act's potential effect on shareholder welfare is multiple. Even if the Act results in an increased premium to target shareholders when successful tender offers are made, one also must consider its effects on both the incidence of tender offers and the likelihood of tender offers succeeding once made.²⁴⁶ Professor DeMott, commenting on the European restrictions on shareholder voting rights—particularly those rules limiting a single owner's voting power to a stated percentage—concludes: The experience on the European continent with restrictions on the voting power of shares demonstrates that such restrictions can effectively preclude the appearance of hostile bids."²⁴⁷

245. *Id.* at 839.

246. See Coffee, *supra* note 226, at 1183-86 (an economic analysis of these conflicting effects with respect to shark repellent amendments). Professor Coffee concludes that the net effect of this tradeoff on shareholders is indeterminate. For an earlier analysis of the net effect of the Williams Act and first generation state antitakeover statutes on shareholders, see Jarrell & Bradley, *supra* note 2 at 404. Professors Jarrell and Bradley conclude that such legislation, although it increased the premiums paid in successful tender offers, also reduced the incidence of tender offers and not just those tender offers which left nontendering shareholders with lower share values.

247. DeMott, *Comparative Dimensions of Takeover Regulation*, 65 WASH. U.L.Q. 69, 79 (1987).

2. *Achieving Synergistic Gains*

Another possible social benefit of takeovers is the possibility of synergistic gains—gains in performance due to factors other than the replacement of inefficient target management. Synergy is merely a label applied to combinations where the value of the combined company exceeds the sum of the values of the two companies individually. Synergistic gains can result from a number of factors—economies of scale, reduced capital or borrowing costs, and product complementarity.²⁴⁸ Such synergistic gains represent true increases in social value; the same assets are producing more goods for the same price or the same amount of goods for a cheaper price. Takeovers, therefore, are beneficial to society if the synergistic gains outweigh the other costs associated with the takeover.²⁴⁹

B. The Arguments for Regulation

Critics argue that hostile takeovers produce a number of socially undesirable effects. They claim that target shareholders are unfairly coerced into accepting offers at a price below the intrinsic value of the target. They claim that takeovers lead to excessive corporate debt and a focus on short-term profits rather than on long-term capital investment or research and development. They argue that hostile takeovers have an adverse effect on the local communities in which target companies are located and on employees, creditors, suppliers, and customers of the target. They argue that hostile takeovers are little more than economically inefficient empire-building by the bidder. Although these arguments have popular appeal, a closer look shows that corporate takeovers on the whole are beneficial. Furthermore, any problems that may exist are not solved by the Nebraska Act.

1. *Preventing the Coercion of Target Shareholders*

One of the arguments frequently made against takeovers and in support of provisions such as those in the Nebraska Act is that shareholders are coerced into accepting tender offers that do not fairly compensate them for the "intrinsic value" of the company. Shareholders would be better off under existing management, the argument goes, but are unable to resist the pressures to tender.

The weak form of the shareholder coercion argument focuses on two-tier offers, where the bidder offers a premium price for a controlling interest (usually fifty-one percent), then after obtaining control

248. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1031-32 (1982); Coffee, *supra* note 226, at 1166-67.

249. The term "costs" is used loosely here to include not only the transaction costs incurred in combining the two companies but also any other social costs caused by the takeover that are not merely redistributions of wealth.

engages in a merger to cash out the remaining shareholders at a lower price. For example, assume that the pre-offer market price of the target stock was \$30 per share. The bidder makes a tender offer for fifty-one percent of the target's stock at a premium price of \$40 per share and announces that, upon obtaining control, the acquiring company will enter into a cashout merger with the target in which the remaining forty-nine percent of the shares will receive \$18 per share. If the bidder does not receive tenders for fifty-one percent of the stock, he will not purchase any stock. The shareholder has to choose whether or not to tender. In the case of most shareholders, the probability that the tender offer will succeed is only slightly affected by their individual choice; therefore, they may ignore the effect of their individual choice on the probability that the tender offer will succeed and take the probability of success as a given. With that assumption, it is *always* in each shareholder's self-interest to tender his shares if the first-tier price exceeds the second-tier price, no matter how low the average, blended price of the offer.

The individual shareholder's decision is diagrammed in Figure B. If he decides to tender and the offer fails, he keeps his stock, which presumably will fall back to the pre-offer price of \$30 per share.²⁵⁰ If he decides not to tender, and the offer fails, the result is the same. Thus, if the offer ultimately fails, it makes no difference to the shareholder whether or not he tendered.²⁵¹ If the shareholder tenders his stock and the offer succeeds, he receives either \$40 per share or some pro rata blend of \$40 per share and \$18 per share, depending on whether or not the offer is oversubscribed. This value will always be higher than the second-tier cashout amount he receives if he does not tender (\$18 per share). Thus, no matter what the probability of success, and no matter what the second-tier price—as long as it is less than the tender offer price—the shareholder should tender.²⁵² If the shareholders behave rationally, they will all tender, and the offer will succeed even though the blended price to the shareholders in the example would be only \$29 per share, which is less than the value of the shares if the shareholders did not tender and the offer failed. The

250. Whether the stock actually falls to the pre-offer price or remains at some higher price if the tender offer does not succeed does not matter in evaluating the weak form of the coercion argument.

251. This conclusion is dependent on the assumption that the bidder does not purchase any shares if the desired 51 percent is not tendered. If the bidder is willing to purchase tendered shares even when he does not succeed in getting control, the balance is tipped even more in favor of tendering. The shareholder would then receive \$40 per share if he tendered and the offer failed. In that scenario, the assumption that the stock price falls to its pre-offer level after an unsuccessful tender offer is crucial. If not, the shareholder may have a greater incentive not to tender.

252. This proposition can be proven mathematically. Assume the following variables:

problem is that shareholders cannot coordinate their response in deciding whether to tender and, therefore, are unable to affect the probability of success. Because of this coordination problem, the offeror has coerced the shareholders into accepting less than market value for their shares.

Front-end loaded, two-tier tender offers have never constituted a large part of the total number of tender offers and are even less prevalent today than in the past.²⁵³ Thus, the two-tier bid is simply not a major problem. However, Professor Bebchuk points out that tender offers might be unfairly coercive even where there is no second-tier cashout.²⁵⁴ He notes that a successful bidder can decrease the value of the minority's continued investment even without cashing them out

T = Tender offer price,

S = Second-tier price in cashout merger of minority shareholders,

M = Pre-offer market price,

p = Probability that the tender offer will succeed,

(1-p) = Probability that the tender offer will fail.

Make the same assumptions that are made in the text:

1. $T > S$,
2. p is independent of the individual shareholder's decision to tender,
3. The market price after an unsuccessful tender offer is equal to the pre-offer price (M).

To simplify the calculations, assume the worst-case scenario for the tendering shareholders. If the offer succeeds, 100 percent of the shareholders will tender, so that each shareholder receives the lowest possible blended price.

The expected value of *not tendering* is then $pS + (1-p)M$. The expected value of *tendering* is then $p(.51T + .49S) + (1-p)M$. The proposition to be proven is that

$$p(.51T + .49S) + (1-p)M > pS + (1-p)M$$

Subtracting the common term from both sides of the equation yields:

$$p(.51T + .49S) > pS$$

Simplifying:

$$.51pT + .49pS > pS$$

Subtracting .49pS from each side yields:

$$.51pT > .51pS$$

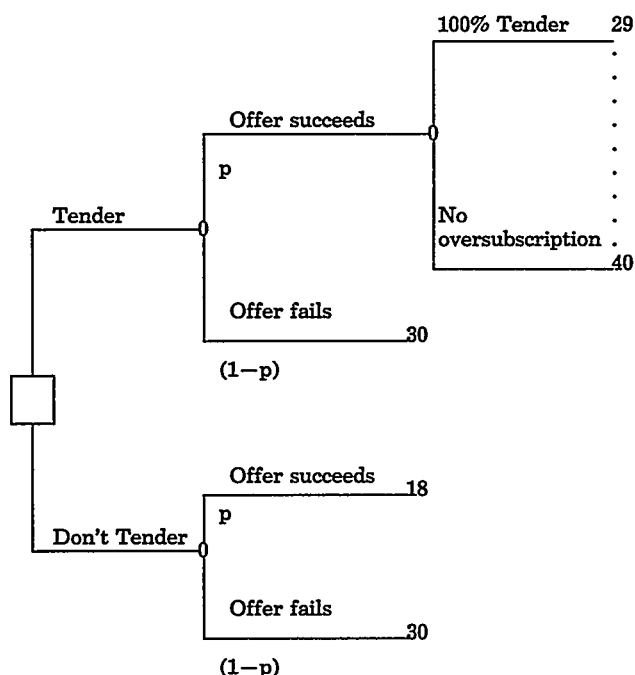
Dividing each side of the equation by the common factors (.51p) yields:

$$T > S.$$

Because this is true by definition, the equation is proven. The expected value of tendering is greater than the expected value of not tendering.

253. Langevoort, *supra* note 206, at 105; Lipton, *supra* note 237, at 19. Lipton argues that there is no guarantee that this technique will remain dormant, but if there is a resurgence of two-tier tender offers, the problem can be met legislatively at that time. Two-tier offers have subsided as the availability of junk bond financing has increased, suggesting that their primary function was not to coerce target shareholders but to help finance larger takeovers where the offeror could not afford to buy 100 percent of the stock initially.
254. Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 917-31 (1987) [hereinafter *The Pressure to Tender*]; Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1708-33 (1985) [hereinafter *Toward Undistorted Choice*].

FIGURE B



by operating the business to divert part of the target's profits to itself.²⁵⁵ This could lower the market value of the minority's shares below the pre-offer market price. Professor Bebchuk also notes that the acquirer might find it beneficial to defer the eventual takeout to a later date because (1) inside information would help predict whether a cashout merger would be profitable, and (2) the acquirer might be able to manage the corporation in the interim period to manipulate the eventual cashout price. Anticipation of a future cashout also would decrease the market value of the minority's shares. Bebchuk thus argues that the acquirer's operation of the firm with continued minority ownership could reduce the value of the shareholders' investment just as much as a second-tier cashout.

In either case (cashout merger or continued operation), shareholders clearly suffer if the blended price is less than the pre-offer market price of the company. In addition to unfairly compensating target shareholders, this result is not economically efficient. The corporation ends up in the hands of a bidder who may value its assets less than their market value under existing management. The assets do not necessarily go to the highest-value user. In the example above, the

255. *Toward Undistorted Choice*, *supra* note 254, at 1711-13.

offeror would pay a total acquisition price of \$29 per share even though the market valued the company at \$30 per share in the hands of existing management. Almost everyone would concede that the takeover is not beneficial. However, such a result is unlikely. On average, shareholders in the second tier of two-tier tender offers receive substantial premiums over the target stock's pre-offer market price.²⁵⁶ In many two-tier offers, the second-tier price is equivalent to or higher than the tender offer price.²⁵⁷ Even if the successful offeror does not cash out the minority, the minority shares continue to be valued at a premium above the pre-offer market price.²⁵⁸ Any attempt to cash out the minority at a price below the pre-offer market price would almost invariably run afoul of the minority's appraisal rights.²⁵⁹ If the bidder does not cash out the remaining minority, current fiduciary duty law clearly allows the bidder to divert some value from the minority, and this diversion should lower the market price of the minority's shares. However, the tender offer price is on average about sixty percent higher than the pre-offer market price of the target.²⁶⁰ Assuming a first-tier offer for only fifty-one percent of the target's stock, the acquirer would have to divert around sixty percent of the value from the remaining shares before the blended price would be less than the pre-offer market price. Although fiduciary duty review tolerates some diversion of profits, it is unlikely to tolerate a diversion of this magnitude. Thus, it is extremely unlikely that the blended price of a tender offer would be less than the pre-offer price.

Bebchuk and others go beyond this weak form of the coercion argument and argue that tender offers are coercive and unfair to shareholders even if the second-tier price (or the value of minority shares if there is no cashout)²⁶¹ exceeds the pre-offer price.²⁶² For example, assume once again that the pre-offer market price of the target's stock is \$30 per share and the offeror offers to buy fifty-one percent of the stock at a price of \$40 per share. The second-tier price is \$32 per share. The blended price is now approximately \$36 per share, well above the original market price, but Bebchuk nonetheless argues that the target shareholders are disadvantaged and that the existence of a blended

256. See Office of the Chief Economist, SEC, *The Economics of Any-Or-All, Partial, And Two-Tier Tender Offers* (1985)(finding overall premiums in two-tier tender offers in 1981-1984 averaging over 50 percent).

257. Gilson, *supra* note 224, at 861.

258. Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 35 J. BUS. 345, 360-365 (1980).

259. Bebchuk concedes this. See *Toward Undistorted Choice*, *supra* note 254, at 1709-10.

260. Office of the Chief Economist, SEC, *supra* note 256; see also *infra* note 268.

261. For convenience, I will refer only to the second-tier price. The analysis is also valid in situations where the acquirer continues to operate the firm without cashing out the minority.

262. See, e.g., Lowenstein, *supra* note 227, at 307-09; Lipton, *supra* note 237, at 18-19.

above-market price does not insure that the corporation is going to a more productive user.

The problem with Bebchuk's argument is that it presupposes an inefficient stock market that does not properly value the target's shares. The pre-offer market price reflects investors' estimates of the target's value under the direction of existing management.²⁶³ Any offer in which the blended price exceeds the pre-offer market price of the stock should represent a return to a majority of the shareholders in excess of the market valuation of the target in the hands of incumbent management. Such an offer, therefore, is both efficient, because it is likely to place the corporation in the hands of a more productive owner, and fair, because shareholders receive a return in excess of their own collective valuation of the target.

Professor Bebchuk offers several arguments why this might not be true, but on closer examination, each of these arguments is flawed. First, Professor Bebchuk notes that target shareholders receive a great deal of new information during the bid—market participants evaluate the target more thoroughly, target management discloses new plans and proposals, and investors draw inferences from the making of the bid itself.²⁶⁴ Bebchuk argues that this new information will cause target shareholders to increase their estimates of the independent target's value above the pre-offer market price. Even though the bid is at a premium above the pre-offer market price, it may actually be below the shareholders' revised valuation. To support his thesis, Bebchuk points to a study by Professors Bradley, Desai, and Kim showing that the market price of target stock remains significantly higher than the pre-offer market price even after a tender offer is rejected.²⁶⁵ Bebchuk sees this data as evidence that tender offers cause target shareholders to revalue their company; otherwise, the stock should return to its pre-offer level. However, that same study indicates that the reason for the continued higher price is the expectation of another bid for the company. If no further bid is made, the price of the target stock returns to its expected level within five years.²⁶⁶ Thus, the post-bid price is higher not because shareholders have revalued the target, but because they expect another premium bid. If the expected bid does not materialize, the shareholders' valuation of the company under incumbent management returns to the expected level.

263. If the market price did not represent the true value of the target under existing management, investors could profit by purchasing the company's shares at the lower market price. Investors would have an incentive to make such purchases until the market price equalled the "true value" of the shares. Thus, the market price would quickly reach equilibrium.

264. *The Pressure to Tender*, *supra* note 254, at 928.

265. *Id.* at 929. See Bradley, Desai & Kim, *The Rationale Behind Interfirm Tender Offers: Information or Synergy?*, 11 J. FIN. ECON. 183 (1983).

266. Bradley, Desai & Kim, *supra* note 265.

This is inconsistent with Bebchuk's thesis. Under Bebchuk's thesis, any revaluation should persist over time.²⁶⁷

Finally, it is difficult to envision revaluation during the course of the offer of the magnitude that Bebchuk's thesis would require. Because the first-tier price averages over sixty percent above the pre-offer market price, and second-tier premiums average over forty percent above the pre-offer market price,²⁶⁸ the average blended price in a fully prorated two-tier buyout is more than fifty percent above the pre-offer price.²⁶⁹ It is hard to envision new information sufficient to raise the value of the target stock to such an extent. Thus, even if there is a revaluation, it is likely that the blended tender offer price still exceeds the revalued price.

Professor Bebchuk also argues that even in the absence of new information, shareholders might rationally want to reject a bid above their pre-offer valuation if they expect an even higher bid in the future, either from the same bidder or from a competing bidder.²⁷⁰ However, if there is another potential bidder to whom the target is more valuable, that other bidder could be expected to come forward with a higher offer under the present rules, rather than let the first bidder succeed. Assume that the pre-offer market price of the stock is \$50 per share. Offeror A makes a tender offer for fifty-one percent of the stock at a price of \$80 per share, and announces that he will cash

267. Bebchuk's reliance on any increased value resulting from plans and proposals put forth by target management in defending against the takeover is troubling for another reason. Such plans and proposals are a classic illustration of the efficiency effects of hostile takeovers. Management's ability to come up with proposals to increase shareholder value indicates that management was operating inefficiently prior to the tender offer. The tender offer has forced management to operate more efficiently. Rules such as those set forth in the Nebraska Act make tender offers less likely and, therefore, make such efficiency-increasing plans and proposals less likely. This gives target management a strategic advantage. Management may operate the company inefficiently, and propose efficient operation only when a takeover appears imminent. Once the threat has passed, the inefficient operation may resume at the expense of the shareholders. Given this strategic possibility, it is unclear that shareholders would significantly revalue their shares as a result of management proposals.

268. Office of the Chief Economist, SEC, *supra* note 256 (based on a study of over 200 successful tender offers during the period 1981-1984). Jarrell, Brickley & Netter report a follow-up study by the Office of the Chief Economist of tender offers in 1985 and 1986 which found lower overall premiums, 37 percent in 1985 and 33.6 percent in 1986. See Jarrell, Brickley & Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSPECTIVES 49 (1988). They also report an unpublished study by Jarrell and Poulsen finding overall premiums of 30 percent for successful tender offers in the period from 1980 to 1985. *Id.* at 51. These lower figures would not significantly affect the conclusion in the text.

269. This assumes a first-tier tender offer for 51 percent of the target's stock and tender by 100 percent of the shareholders.

270. *The Pressure to Tender*, *supra* note 254, at 929-30.

out the remaining forty-nine percent at a price of \$50 per share. This constitutes a blended price of approximately \$65 per share. Now assume, as Bebchuk does, that for some reason the pre-offer price was below the true value of the target in the hands of existing management, and that its actual value is \$75 per share. The target shareholders would prefer to reject the below-value offer, but, according to Bebchuk, would be coerced into accepting. However, the possibility of competing bids makes this unlikely. A competing bidder would find it profitable to make an offer with a blended price greater than \$65 per share but less than \$75 per share. Thus, competition in the market for control would gradually dissipate the supposed difference between the true value of the firm and the price offered to the shareholders until the two-tier, blended price equalled the shares' true value. This would be true even if the company were worth \$75 per share only in the hands of existing management, because management itself would then have an incentive to outbid Offeror A by means of a management buyout (or any other investor would find it worth his while to buy the stock and leave the existing management in power). Competition should drive the bid price to a point where shareholders could not rationally expect a higher bid.²⁷¹ The bidder to whom the target was most valuable would offer the highest bid and the assets would go to the highest-value user.

The Williams Act provides a minimum delay period of at least twenty business days for competing bids to arise,²⁷² and existing management has broad discretion under existing law to solicit additional bids. Bebchuk concedes that the Williams Act delay period is often sufficient to bring forth competing bids, and offers no evidence that it is ever insufficient.²⁷³ Professor Ruback has demonstrated that the market for corporate acquisitions is competitive and that, in most cases, the bid price exceeds that which could profitably be offered by other bidders.²⁷⁴ Thus, the empirical evidence refutes Bebchuk's argument.²⁷⁵ If twenty business days is too short, the delay period can

271. See Lehn, Blackwell & Marr, *The Economics of Leveraged Takeovers*, 65 WASH. U.L.Q. 163, 183-184 (1987); Lowenstein, *supra* note 227, at 307.

272. SEC Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1987).

273. *The Pressure to Tender*, *supra* note 254, at 929.

274. Ruback, *Assessing Competition in the Market for Corporate Acquisitions*, 11 J. FIN. ECON. 141 (1983).

275. Critics often point to situations in which an initial bid is rejected and shareholders later receive a higher bid. Three responses are appropriate. First, a later, higher bid is more valuable to target shareholders only if it exceeds the present value of the initial bid. Because of the delay between the bids, this is often not the case. Second, the existence of such situations is itself evidence that shareholders are able to reject inadequate initial bids under the existing legal rules. No further legislation is needed to protect them. Finally, such arguments often fail to account for general price changes during the time separating the two bids. A superficially higher second bid may not be higher in real terms.

be extended; no other legislation is needed.

Bebchuk contends that the initial offeror may have a strategic advantage that would prevent other bids from coming forward, thereby lowering the price paid to target shareholders. He offers the following example:

For example, consider a case in which both A, the first bidder, and B, another potential offeror, value the target by \$X per share, and B is aware of A's valuation of the target. A has already incurred the transaction costs involved in making a tender offer, and now B is considering whether to make these expenditures and advance a rival bid. Because the transaction costs involved in A's bid are sunk, A will be prepared to raise its bid for the target to anything less than \$X per share. Thus, to win a contest over the target, B will have to bid \$X per share in addition to spending the transaction costs involved in making a bid. Consequently, B's rational decision will be not to enter into a contest with A, even though B's valuation of the target is the same as A's.²⁷⁶

There are two problems with this argument. First, Bebchuk assumes that the second potential bidder is aware of the first bidder's valuation of the target. This is unlikely to be true; tender offerors' valuations of the target company are closely guarded and hard to estimate. If B is not aware of A's valuation, it makes perfect sense for B to bid in the hope that A places a lower value on the company than B does. Second, Bebchuk assumes that both bidders place the same value on the target. If B's valuation is higher than A's by at least the amount of the transaction costs involved in making a second bid, B would bid even if B knows A's valuation. If the two bidders do place equal values on the target and B knows A's valuation, Bebchuk is correct that target shareholders may receive a lower price, but this is not economically inefficient. Since the two valuations are equal, the target assets still end up in the hands of one of the two highest-value users. The allocation of gains between the initial bidder and the shareholders in this case is purely a distributional concern.²⁷⁷ Empirical studies indicate target shareholders fare quite well in this distributional game; it is typically the selling target shareholders rather than the successful bidder who receive the greatest abnormal returns.²⁷⁸

Finally, Bebchuk argues that "the shareholders might believe that the bidder's motive for making the bid was the possession of private information that the target's shares were undervalued by the market; and the shareholders might conclude that the target's accurate value exceeds the offered acquisition price."²⁷⁹ Bebchuk necessarily focuses

276. *The Pressure to Tender*, *supra* note 254, at 1036 n.45.

277. The highest-value bidder for any asset will never pay his full valuation to the seller of that asset. He will only need to pay a slight increment above the price offered by the next highest-value user. A sale is in the seller's best interests at such a price, even though it allows the buyer to retain some of the gains, because the seller has no other use of the asset which would provide as great a return.

278. See R. GILSON, *supra* note 227, at 441.

279. *The Pressure to Tender*, *supra* note 254, at 930.

on private information of undervaluation because any publicly available information that the target stock was undervalued would result in arbitrage and competitive tender offer bidding that would quickly drive the offer price to the proper level. But why would a hostile bidder have private information that the target's stock is undervalued? If there really is such information, surely the target's management has it as well. They could release it publicly or to another bidder and force the first bidder to pay a competitive price in an auction. The situations where private information of undervaluation is most likely to exist are in management buyouts or management-negotiated deals. In either case, the bidder is likely to have access to inside information not available to the market. Yet, these situations are exempted from the Nebraska Act, leading one to question the Act's commitment to protecting shareholders from receiving unfair compensation for their shares.

The argument that shareholders are coerced into accepting unprofitable tender offers also disregards the presence of institutional investors and arbitrageurs who purchase substantial positions from existing shareholders after the tender offer is made. As Gilson points out, these arbitrageurs serve a valuable risk-taking function by allowing risk-averse shareholders to sell at a favorable price without incurring the risk that the tender offer will not succeed.²⁸⁰ However, they also help protect against coercion of the target's shareholders. The coercion argument is premised on the inability of target shareholders to coordinate their response and negotiate with the offeror. Arbitrageurs, in concert with institutional investors, have much greater bargaining power and much lower costs of coordination and cooperation. Their cooperative response to tender offers makes coercion much less likely.²⁸¹

The discussion above points to a single conclusion: it is highly unlikely that a tender offeror will be able to obtain control of a target company, even in a two-tier offer, at a blended price below the actual value to the target shareholders of their stock. Thus, the possibilities of coercion or unfair treatment of target shareholders are negligible.

A final response to the shareholder coercion argument focuses on the pre-offer price of the target stock. Assume that hostile tender offers are coercive and unfairly compensate target shareholders. Inves-

280. Gilson, *supra* note 224, at 855-56.

281. Professor Bebchuk's arguments on this point are somewhat inconsistent. He argues that the intervention of arbitrageurs and other buyers should not matter because no matter how many times the shares change hands, whoever holds them at the moment of truth is faced with the same coerced decision. *Toward Undistorted Choice*, *supra* note 254, at 1727. However, in an earlier work, he admitted that the existence of large shareholders who could take into account the effect of their tender decision on the success of the offer would strengthen the bargaining position of the target's shareholders. Bebchuk, *supra* note 248, at 1040.

tors in the market are certainly aware of this, so they will discount the price to account for the risk that they will be coerced into selling the stock for less than fair value.²⁸² The investor will pay a lower price for the stock, with the difference between the price paid and the "actual value" being the discounted expected loss associated with the risk of a coercive hostile takeover. Thus, shareholders would be fully compensated for the risk of coercion when they purchase their stock. They suffer no real loss when the "coercive" takeover actually comes.²⁸³

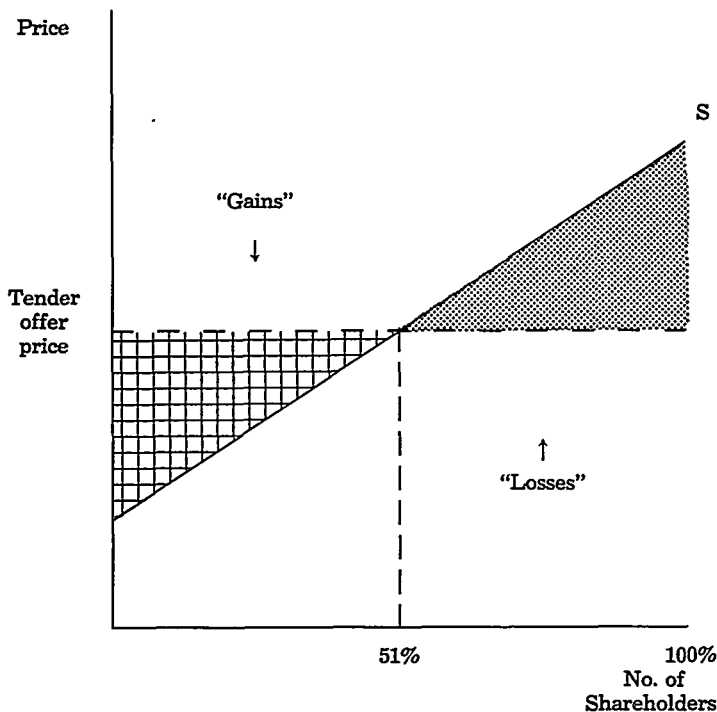
Professor Carney argues that hostile takeovers are unfair to some shareholders even when the majority is not unfairly pressured into deciding and the majority receives a blended price above its valuation of the target company.²⁸⁴ Carney begins by assuming an upward-sloping supply curve for the target shares. If the bidder wants majority control, he sets the tender offer price at a level so that the price offered equals or exceeds the valuation placed on the company by fifty-one percent of the shareholders (See Figure C). However, this price is necessarily lower than the valuation placed on the firm by the remaining forty-nine percent of the shareholders due to the assumption that the supply curve is upward-sloping. If the bidder can cash out these other shareholders in a second-tier transaction at the same price, they suffer "losses" equivalent to the shaded area in Figure C. These losses may or may not be fully offset by the countervailing gains to shareholders who sell for more than their reservation price (cross-checked area in Figure C). If the loss to the minority exceeds the gain to the majority, shareholders suffer a net loss. The problem with this argument is that if the minority losses really exceeded the majority gains, the minority could buy out the majority by making a tender offer at a higher price. Carney's argument is thus another example of the failure to consider the effects of competition—in this case competition from the allegedly injured minority. Also, many successful tender of-

282. To the extent that this risk is diversifiable, as by purchasing the stock of acquiring companies likely to receive the gains from any such coercion, the diversified shareholder receives no net harm from any coercion, and no discount is necessary. To the extent that such risk is not diversifiable, the risk should be reflected in the price of the stock.

283. There may be some shareholders who purchased their stock before the advent of hostile, two-tier takeovers. Since the risk was not known at the time of their purchase, the price they paid for their stock was not discounted for that risk, and they are losers if they are coerced into accepting a tender offer for less than fair value.

284. See Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. RES. J. 341, 354-57 (1983) [hereinafter *Shareholder Coordination Costs*]; Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 112-15 (1980) [hereinafter *Fundamental Corporate Changes*].

FIGURE C



fers are oversubscribed, indicating that the bidder does not set the premium at a level low enough to capture all of this value from the minority. This reduces the minority losses, making it even more likely that the majority's gains exceed the minority's losses. Finally, unfairness or coercion of this sort is a necessary feature of majority (or even supermajority) rule. Any majority shareholder action, whether or not related to a hostile takeover, is capable of imposing such losses on the minority. Carney's real objection is not to hostile takeovers but to the long-standing notion of corporate governance by majority rule. In any event, the Nebraska Act does little to prevent this type of coercion. A majority of the shareholders can still approve an acquisition, and the majority, through their control of the board, can even allow the bidder to cash out the remaining shareholders.

Because shareholders are not unfairly coerced into accepting tender offers, the Nebraska Act cannot be justified on that basis. But what if tender offers are coercive—would the Nebraska Act protect against such coercion? A tender offeror who wants full control of the corporation must first receive a favorable vote from the shareholders pursuant to sections 21-2450 and 21-2451 of the Act. If the sharehold-

ers do not like an offeror's proposal, they can refuse to grant him voting rights. This would not stop him from acquiring the shares in a tender offer, but a successful bidder would be unable to do a second-tier transaction without approval from the other shareholders at some point, either when they initially granted him voting rights or when they approved the second-tier transaction. Thus, if the shareholders felt that the second-tier transaction was unfair, they could simply vote against it.²⁸⁵ The shareholder decision on voting rights would not affect the value they would receive if the offer succeeded. Shareholders could disapprove the voting rights, but still tender their shares and capture the full value of the offer, should it succeed. This resembles the separate vote on the success of the tender offer suggested by Professor Bebchuk to eliminate what he sees as coercion.²⁸⁶

Of course, the Nebraska Act's voting rights limitation comes at a cost. The costs are the additional time given to target management to engage in obstructive tactics and the additional cost to the bidder of extending his financing until shareholder approval is obtained. Obstructive tactics by target management are made even more likely by the amendments to the duties of directors adopted as part of the same bill.²⁸⁷ These amendments allow the directors of Nebraska corporations to consider the interests of the community, employees, and suppliers in acting on behalf of the corporation. Now, in responding to tender offers, the target directors need not even engage in the pretense that obstruction of the offer is in the best interests of their shareholders.²⁸⁸ The resulting deterrence of tender offers, and the

285. The initial vote on the voting rights of the control shares would not necessarily constitute approval or disapproval of the second-tier transaction. However, the federal tender offer rules would require disclosure of any second-tier transactions planned at the time of the offer. See Schedule 13D, Item 4, 17 C.F.R. § 240.13d-101 (1987); Schedule 14D-1, Item 5, 17 C.F.R. § 240.14d-100 (1987). The target shareholders, with this information, presumably would deny full voting rights if they felt that the blended price of the tender offer and the proposed second-tier transaction would provide less value to them than existing management's continued operation of the corporation. This assumes that the tender offer is conditioned on the receipt of full voting rights. If the tender offer is not so conditioned, the shareholders would approve voting rights only if they felt that the second-tier transaction would be more valuable to them than the offeror's operation of the firm.

286. See *Toward Undistorted Choice*, *supra* note 254, at 1747-50. See also *The Pressure to Tender*, *supra* note 254, at 931-35. Professor Bebchuk considers a separate shareholder vote such as this only a second-best solution because it involves higher transaction costs and results in greater delays than his proposal. See *Toward Undistorted Choice*, *supra* note 254, at 1757-59; *The Pressure to Tender*, *supra* note 254, at 934-35.

287. NEB. REV. STAT. § 21-2035 (Cum. Supp. 1988).

288. Professor Gilson argues that an Indiana-type statute may actually make it more difficult for target management to engage in defensive tactics to obstruct the offer:

loss of shareholder value that such deterrence is likely to cause, must be balanced against any gains from reducing coercion. Because, as argued above, any coercion is minor, the net effect is undoubtedly negative.

An additional problem with the Nebraska voting rights limitation, even if one accepts the coercion argument, is that it does not stop the successful offeror from penalizing non-tendering shareholders. Bebchuk sees two ways in which the minority remaining after a partial acquisition is penalized. The first way is by a second-tier cashout at a below-value price. The Nebraska Act protects shareholders from that strategy. The second way is by the acquiring person's continued operation of the firm at the expense of the minority. The acquirer could capture a disproportionate amount of the returns to itself through self-dealing, above-market compensation, and other forms of allocative inefficiency. Bebchuk argues that anticipation of this outcome also coerces shareholders into tendering because allocative inefficiency reduces the value of any shares not tendered.

The Nebraska Act does little to prevent such allocative inefficiency by the acquiring person. Even without shareholder approval, the acquiring person has the power to elect the board of directors and to manage the corporation through the board. As long as the acquiring person takes no extraordinary action requiring shareholder approval (in which case the acquiring person would be ineligible to vote), the acquiring person is free to divert benefits to himself, subject only to

A second advantage that a fifty day delay might provide target management is the chance to undertake defensive tactics that might cause the acquirer to withdraw the offer before the vote. The problem with this idea, however, is that a court would be hard pressed to justify management action that had the effect of interfering with the shareholders' opportunity to approve an offer in a vote required by statute. Put in terms of the current Delaware proportionality test, where a statute mandates a shareholder vote and effectively prohibits the offer unless the shareholders approve it, what possible threat could be reasonably related to precluding shareholders from voting in favor of the offer? Indeed, even an action like a restructuring that purported to give the shareholders greater value might be problematic because management could have presented the restructuring to shareholders as an alternative to the offer and thereby not prejudiced the vote mandated by the statute.

R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 197 (Supp. 1987)(citation omitted). The problem with this argument in the context of the Nebraska Act is that it assumes a standard for director action that focuses solely on the interests of the shareholders. If this is the standard, Gilson is correct that actions by directors to prevent shareholders from voting on the offer are problematic. However, as a result of the amendments to section 21-2035, that is no longer the standard in Nebraska. Directors now may also consider non-shareholder interests, and if such consideration is to have any meaning at all, the directors could favor those non-shareholder interests over the interests of the shareholders. Defensive tactics to obstruct the offer then could be justified as protecting those non-shareholder interests even if the shareholders would prefer to vote on the offer.

normal fiduciary duty review.²⁸⁹

The five-year prohibition on business combinations provides some additional protection against this second type of coercion, but not much. Insofar as it prohibits mergers and sales of substantially all of the corporation's assets,²⁹⁰ it is statutory overkill. The voting rights approval requirements already protect minority shareholders from unfair second-tier cashouts. This additional, and absolute, ban on such transactions precludes second-tier transactions that a majority of the disinterested shareholders feel are in their best interests, and thus results in inefficiency.

The business combinations section of the Act also prohibits some transactions that would not require a shareholder vote (which the voting rights section of the Act therefore would not protect against). These include sales of less than substantially all but more than ten percent of the corporation's assets to the controlling person, disproportionate transfers of stock to the controlling person, and loans, guarantees, or other financial assistance to the controlling person.²⁹¹ Each of these represents a way in which a controlling shareholder might capture a disproportionate amount of the corporation's value at the expense of the minority shareholders. However, transactions such as these are also the type of disproportionate taking most likely to be adequately controlled by duty of loyalty review. They are highly visible, disclosure is inevitable, and their fairness to the corporation is easily evaluated. Thus, the ban on business combinations provides little additional protection to shareholders. The business combination prohibition does not bar the more prevalent day-to-day takings of value such as above-market compensation, smaller inter-company dealings, and the like. Thus, from the standpoint of coercion, the business combination prohibition is both grossly overinclusive and grossly underinclusive.

It is apparent from the Act's exclusion of management-sponsored buyouts that the Nebraska Act is not designed to protect shareholders from coercion. Shareholders also can be unfairly compensated in takeovers approved by incumbent management. In fact, management approval may come only after the offeror agrees to management protections such as job guarantees and generous severance payments. Although such provisions might be justified as protecting the share-

289. Judicial review of the director's violation of fiduciary duty might prevent such diversion of benefits. For reasons explained earlier, this is doubtful. See *supra* text accompanying notes 235-36. If this conclusion is wrong, and such judicial review is effective, then Professor Bebchuk's argument that shareholders are coerced in the absence of a second-tier merger is simply wrong. Minority shareholders would not be coerced because they would know that they could stop any allocative inefficiency by court action.

290. NEB. REV. STAT. § 21-2437(1), (2) (Cum. Supp. 1987).

291. *Id.* § 21-2437(2)-(5).

holders' long-term interest in retaining good managers, they are just as likely to be a side payment to management to induce management not to oppose the offer.²⁹²

If the Nebraska Act actually benefited shareholders, it would not have to be foisted upon shareholders by the Legislature. The voting rights limitations and the ban on business combinations could have been adopted by the shareholders without any legislative help at all in amendments to the corporation's articles of incorporation.²⁹³ At most, the only legislative action necessary would have been an opt-in enabling act, with actual adoption of the provisions requiring a shareholder vote. The shareholders then could have decided whether the Act's provisions were beneficial. Professor Romano hypothesizes that corporate management lobbies the legislature for provisions such as these only when they feel they would be unable to convince a majority of the shareholders that such provisions are desirable.²⁹⁴ The Nebraska Act, with its forty-five-day opt-out provision left solely to the discretion of the board of directors, does not even give shareholders an opportunity to escape the Act if they feel it reduces the value of their investments.²⁹⁵ This also strongly suggests the Act was motivated not by a desire to protect target shareholders but by a desire to protect incumbent management and to keep assets and jobs in Nebraska—even if those goals come at the expense of the shareholders of Nebraska corporations.

2. *The Effect of Takeovers on Corporate Indebtedness*

Critics of takeovers have objected to the increased amount of debt used by bidders to finance their bids and by target companies to defend against hostile bids.²⁹⁶ Lipton, for example, criticizes the increasing use of junk bonds and bridge loans whereby the assets of the target

292. In a 100 percent cash buyout offer, such guarantees to management and employees should be irrelevant to target shareholders because the shareholders will have no further connection with the target company. If the offer succeeds, the target shareholders' sole financial concern is the amount paid for their stock; any increases in the long-term value of the company go to the new 100 percent owner. If such inducements to management are not associated with a higher price, the target shareholders do not gain.

293. Langevoort, *supra* note 206, at 105-06.

294. Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 130, 181 (1987).

295. There is some evidence that this type of statute would reduce the value of shareholders' investments. See L. SCHUMANN, STATE REGULATION OF TAKEOVERS AND SHAREHOLDER WEALTH: THE EFFECTS OF NEW YORK'S 1985 TAKEOVER STATUTES (FTC Bureau of Economics Staff Report March 1987) (announcement of the New York business combinations statute resulted in a negative abnormal return to the shareholders of 94 New York corporations of approximately \$1.2 billion).

296. Lipton, *supra* note 237, at 20-23; *Hearings, supra* note 35, at 49 (statement of Sen. Hartnett); *Id.* at 66 (statement of Moon Landrieu).

company can be used to help finance the acquisition.²⁹⁷ Opponents of takeovers object to both the increased amount of debt in the economy and the transfer of wealth from debtholders to shareholders supposedly caused by increased leverage.²⁹⁸

The focus on increased debt as something inherently bad is misguided. A corporation has no funds of its own and by its very nature must borrow funds from others to function. Both debtholders and shareholders lend money to the firm; the only difference is in the nature of the firm's obligation to repay.²⁹⁹ Debtholders have a priority on payment, but the amount of their return is usually fixed or, if variable, variable only within a narrow range. Common shareholders are subordinated to the debtholders, but their return varies depending on the performance of the firm.

The nature of the financing does not divert the long-term focus of the firm.³⁰⁰ As the controlling shareholder, a successful bidder owns only a residual claim on the target's discounted cash flow. Regardless of how the bidder finances the takeover, his goal is the same—he must increase the discounted cash flow of the target by an amount sufficient to exceed the premium paid to acquire control. Foregoing profitable long-term investments solely to service takeover-related debt would diminish that discounted cash flow and thereby reduce the bidder's profits.

The successful bidder does have a strong incentive to abandon unprofitable projects in which the target was invested and service the debt with the funds that would otherwise be wasted on these negative-return projects. Abandonment of projects that constitute a drain on the target's earnings enables the bidder to profit from the acquisition, pay off the debt, and coincidentally divert funds from economically inefficient investments. Professors Jensen, Lehn, Blackwell, and Marr³⁰¹ argue that this explains the prevalence of bids for oil companies. As explained by Lehn, Blackwell, and Marr:

Since the early 1980's, the oil industry has been characterized by substantial free cash flow. By the late 1970's, the leveling (and subsequent decline) of oil prices, high interest rates, and increased costs of drilling and exploration caused growth prospects in the industry to decline. Yet, oil companies still had considerable earning ability due to a significant divergence between the price of crude oil and the average cost of extracting proven oil reserves. Rather than distribute the free cash flow to shareholders via stock repur-

297. Lipton, *supra* note 237, at 11-15.

298. *Id.* at 27-28.

299. Lehn, Blackwell, & Marr, *supra* note 271, at 172-73. Retained earnings are in essence borrowings from income that would otherwise be returned to the shareholders.

300. *Id.* at 179-80.

301. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 326-28 (May 1986); Lehn, Blackwell, & Marr, *supra* note 271, at 182.

chases or dividend increases, many oil companies continued to reinvest free cash flow into negative-return exploration projects. Evidence shows that, on average, the market negatively revalued the equity of oil companies upon the announcement of new exploration programs during the late 1970's.³⁰²

The opportunity to divert free cash flow from such negative-return projects and thereby earn a greater return justifies the debt used to finance the premiums offered target shareholders. The premium offered, and the cost of the debt incurred to finance that premium, represent a lower bound on the expected liberation of additional cash flow. The highly leveraged takeover does not destroy economic wealth but actually encourages the redeployment of target assets to more valuable uses, creating economic wealth.

It also has been argued that leveraged takeovers transfer wealth from debtholders to shareholders. The increased leverage makes outstanding debt riskier and, as a consequence, less valuable.³⁰³ Whether or not debtholders are seriously injured by takeovers is the subject of some dispute. Empirical studies have concluded that the impact of takeovers on bondholders is slight.³⁰⁴ Bondholders' losses are likely to be small in comparison to the gains of the target shareholders in most takeovers,³⁰⁵ but it is likely that there will be some losses.³⁰⁶ The transfer may be even greater when the impact on smaller creditors is considered.³⁰⁷

However, such wealth transfers, to the extent that they occur, are likely to be only transitional.³⁰⁸ Bondholders, preferred shareholders, and creditors are capable of protecting themselves by contract.³⁰⁹ If creditors forego protection against such risks, they should receive a higher return in exchange for the increased risk that they face.³¹⁰ Thus, any adverse effect on most creditors should be only temporary, due to their failure to anticipate and guard against leveraged takeovers and takeover defenses.³¹¹ No legislative help is necessary to pro-

302. Lehn, Blackwell & Marr, *supra* note 271, at 182.

303. Lipton, *supra* note 237, at 27-28; Coffee, *supra* note 226, at 1244-45.

304. Coffee, *supra* note 226, at 1246.

305. Lehn, Blackwell, & Marr, *supra* note 271, at 186-87; Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 51 (1986).

306. Coffee, *supra* note 305, at 49.

307. Coffee, *supra* note 226, at 1246.

308. Coffee, *supra* note 305, at 49.

309. Lehn, Blackwell, & Marr, *supra* note 271, at 185; Coffee, *supra* note 226, at 1247-48; Coffee, *supra* note 305, at 45-51. *But see* Lipton, *supra* note 237, at 27 (asserting that such transfers of wealth "arguably cannot be, prevented by contract or other existing constraints").

310. Lehn, Blackwell, & Marr, *supra* note 271, at 185. Indeed, it is difficult to verify that they have not already made this choice. If corporate creditors already receive higher returns to compensate them *ex ante* for the risk of expropriation, then corporate creditors are fully compensated for any *ex post* transfers of wealth.

311. Coffee, *supra* note 226, at 1247-48; Coffee, *supra* note 305, at 45-51.

tect their interests.

Coffee points out that the increased leverage often resulting from takeovers and takeover defenses is just another example of the market for corporate control forcing managers to act in the interests of the target shareholders.³¹² Target shareholders are better able to diversify their investments than managers, who are overinvested in the firm they serve. As a result, managers will be more risk averse than the shareholders would prefer; shareholders, unlike managers, can diversify to protect against firm-specific risk and do not need the firm itself to diversify.³¹³ Managers, on the other hand, see the firm's debt capacity as a buffer protecting them from the risk of future insolvency and, therefore, they underutilize debt.

The corporate takeover is then understandable as a device that disciplines excessive risk aversion on the part of the target management.³¹⁴ Diversified shareholders are able to maximize the value of their investments by forcing management to accept a higher level of risk. The tender offer premium represents, at least in part, the gain that the bidder anticipates from increasing the company's leverage. Even if the bidder is unsuccessful, the restructurings often used by existing management as defensive tactics achieve the same result—management is forced to minimize firm-level diversification and increase the target's leverage. This benefits the shareholders. Under this view, the Nebraska Act, by making it more difficult for a successful hostile bidder to leverage the company to pay for the acquisition, actually takes value away from the shareholders.

Coffee argues that, in addition to creditors, employees and lower level managers are also adversely affected by the increased leverage and risk associated with takeovers. Coffee asserts that these people tend to lack contractual mechanisms to protect themselves and, therefore, suffer from the increased imposition of risk and the dismissals and plant terminations that often follow the increase in leverage. However, Coffee concedes that such dislocations can increase economic efficiency, and, therefore, their net social effect is indeterminate. Also, labor and management contracts can protect against the risk of leveraged takeovers to some extent. Although imperfect, such contractual provisions should compensate employees and management for at least some of the added risk. If these groups choose to forego such contractual protection, they presumably are compensated for doing so. In addition, these groups may to some extent free ride on the protections negotiated by creditors, although as Coffee has pointed

312. See Coffee, *supra* note 305, at 16-24.

313. *Id.* at 16-19. See also Levy & Sarnat, *Diversification, Portfolio Analysis and the Uneasy Case for Conglomerate Mergers*, 25 J. FIN. 795 (1970).

314. Coffee, *supra* note 305, at 70-71, 73-81. Viewed in this way, this is just a special case of the corporate takeover's ability to discipline management inefficiency.

out, this is an imperfect substitute.³¹⁵ Nevertheless, the range of possible protections suggests that, as with creditors, losses to employees and managers caused by leveraged takeovers are mostly transitional.

The Nebraska Act makes leveraged hostile takeovers more difficult. The voting rights limitation should have little effect because the increased leverage is in the shareholders' best interests if it transfers wealth from creditors to shareholders. Shareholders have no interest in the wealth effects on creditors as long as the proposed takeover maximizes shareholder value. It is the business combination portion of the Act that prevents leveraged hostile takeovers. This provision makes it harder for a successful bidder to encumber the corporation with acquisition-related debt.

3. *The Effect of Takeovers on the Long-Term Focus of the Firm*

Critics of hostile takeovers also argue that takeovers and the threat of takeovers "have forced companies to focus on short-term profitability rather than on capital investment, or long-term planning, research, and development."³¹⁶ Martin Lipton argues that "[p]otential takeover targets seek to maximize short-term performance in the hope of averting hostile takeover bids."³¹⁷ He sees this as resulting from the activities of "short-term investors" like arbitrageurs whose only goal is immediate profit and who have no concern for the long-term profitability of the firm. However, the threat of takeovers does not prevent managers from engaging in long-range planning. A successful long-term strategy will be reflected in higher share prices that will in turn discourage takeovers.³¹⁸ Managers, therefore, have an incentive to engage in those activities that will maximize the long-term value of the firm, discounting future profits at the market discount rate. Critics may not agree with the rate at which the market discounts future profits, but there is no reason why investors' views on the time value of money and the appropriate discount rate should be subordinated to management's views. Furthermore, Lipton's attack on the short-term goals of arbitrageurs (as opposed to the alleged long-term goals of other investors) misses the point. Arbitrageurs purchase their shares from other investors who have already shown, by selling their shares, that they consider the premium offered more valuable than the long-

315. Coffee, *supra* note 226, at 1248. The problem is that creditors can be paid to waive their contractual protections and accept an increased risk. In deciding whether to accept such payments, creditors will not consider the effect of their actions on employees and managers.

316. Lipton, *supra* note 237, at 23. *Hearings, supra* note 35, at 49 (statement of Sen. Hartnett); *Id.* at 69 (statement of Gordon McDonald); *Id.* at 71, 73 (statement of Paul Ess); *Debate, supra* note 35, at 9358-59 (statement of Sen. Wesely).

317. Lipton, *supra* note 237, at 24.

318. Easterbrook & Fischel, *supra* note 226, at 1183-84.

term value of their shares.³¹⁹ Arbitrage allows the long-term investors who sell to receive most of the tender offer premium while avoiding the risk that the offer will be defeated, oversubscribed, or never made.³²⁰ The arbitrageurs merely stand as proxies for the interests of Lipton's long-term shareholders.³²¹

Lipton also argues that takeovers divert resources from socially desirable productive activity to the "inherently non-productive activity" associated with tender offers—those activities associated with investment banking firms, law firms, arbitrage firms, investment advisers, and so forth.³²² The money used to pay for tender offers (the premium price for the target shares) is not necessarily diverted from production. The target shareholders are free to reinvest the funds they receive in other productive activities.³²³ It is the other costs of tender offers about which Lipton complains. It is unfortunate that there are transaction costs associated with takeovers, but there are transaction costs associated with most transfers of assets, especially on such a large scale. The existence of transaction costs does not mean that the transfer itself is economically inefficient. Would Lipton have us ban real estate sales because of the funds diverted to real estate brokers and land speculators? Takeovers allow assets to flow to managers who value those assets more highly than their current users and, therefore, increase economic efficiency.³²⁴ The transaction costs involved are relatively small in comparison to the gains to shareholders resulting from corporate takeovers.³²⁵ Takeovers, therefore, increase productivity; they do not reduce it. The transaction costs Lipton disdains are increased by the management discretion and obstructing tactics he supports and by the delays created by the Nebraska Act. Thus, the effect of the Act is to increase the diversion of resources to "non-productive" activities and make it more difficult to place assets into the hands of their most productive users. The Nebraska Act does absolutely nothing to change the profit focus of the target corporation. Transactions that shareholders approved prior to the takeover will still be approved by those same shareholders under the voting rights provision of the Act, and the ban on business combinations does not

319. Gilson, *supra* note 224, at 856; Easterbrook & Fischel, *supra* note 226, at 1183 n.60.

320. Easterbrook & Fischel, *supra* note 226, at 1183 n.60. Recent evidence suggests that the market does react positively to long-term investments in capital and research and development. See Jarrell, Brickley, & Netter, *supra* note 268, at 55, and authorities cited therein.

321. Gilson, *supra* note 224, at 856.

322. Lipton, *supra* note 237, at 24-25. Interestingly, this view makes most of Mr. Lipton's own activities "inherently non-productive" and socially wasteful.

323. Easterbrook & Fischel, *supra* note 226, at 1184; Jensen, *Takeovers: Folklore and Science*, HARV. BUS. REV. 109, 113-14 (Nov.-Dec. 1984).

324. See *supra* text accompanying notes 224-28.

325. Jensen, *supra* note 323, at 113.

prevent the corporation from reorienting its business to a shorter-term focus.

4. *Protecting Non-Shareholder Groups*

Another argument frequently advanced against hostile takeovers is that they have an adverse effect on corporate employees and on the communities in which the target corporation has facilities. Lipton argues that "[t]he current wave of highly leveraged takeovers has threatened or caused the flight of business operations upon which communities have come to rely and disrupted settled relationships between the target companies and employees, customers, and suppliers."³²⁶ Individual communities often are highly dependent on employment and tax revenues provided by a single corporate employer. The corporation and its management and employees often contribute heavily to the charities and cultural activities of that community. Opponents of hostile takeovers argue that the acquiring company is likely to fire employees, sell off the local plant, and contribute less to the community, all in the name of efficiency.

This was one of the concerns underlying the passage of the Nebraska Act.³²⁷ Several witnesses argued that successful corporate takeovers result in plant closings and the loss of jobs.³²⁸ Witnesses noted Sir James Goldsmith's attempted takeover of Goodyear in 1986 and the potential loss of the Goodyear plant in Lincoln.³²⁹ Senator Wesely pointed to Enron's merger with a white knight, Houston Natural Gas, and Houston Natural Gas's subsequent relocation of Enron to Houston.³³⁰ Senator Johanns probably phrased the issue in the bluntest manner:

One of the reasons I support this is because one of the things that a hostile takeover attempts to do is to drive the bottom line for stockholders. Not all corporations are 100 percent interested in the bottom line and get involved in such things as community projects, donating high schools, being a good corporate citizen which really adds to the benefit of having that corporation in the community. If they are forced to look at profits only and bottom line only,

326. Lipton, *supra* note 237, at 25. Lipton argues that directors should be free to consider these non-shareholder interests in responding to hostile takeovers. *Id.* at 36-43.

327. This was also one of the concerns underlying a 1988 amendment to the NBCA allowing corporate directors to consider the effects of corporate action "on employees, suppliers, creditors, and customers of the corporation and communities in which offices or other facilities of the corporation are located." NEB. REV. STAT. § 21-2035(1) (Cum. Supp. 1988).

328. *Hearings, supra* note 35, at 49-50 (statement of Sen. Hartnett); *Id.* at 66-67 (statement of Moon Landrieu); *Id.* at 69 (statement of Gordon McDonald); *Id.* at 92-94 (statement of Bill Stadtwald).

329. *See, e.g., id.* at 54-55 (statement of Sen. Wesely); *id.* at 68-69 (statement of Gordon McDonald); *Debate, supra* note 35, at 9357 (statement of Sen. Johanns); *id.* at 9358-59 (statement of Sen. Wesely).

330. *Debate, supra* note 35, at 9359 (statement of Sen. Wesely).

those are the first things they cut out.³³¹

Ironically, the Act would not have prevented either of the takeovers which concerned the proponents of the bill. As the bill's proponents recognized in the legislative debates, the Act would not have applied to the proposed takeover of Goodyear because Goodyear would not be an "issuing public corporation."³³² It is not a Nebraska corporation and does not have its principal executive offices in Nebraska. The Act also would not have prevented the Enron move. Enron's merger with Houston Gas was a friendly transaction and undoubtedly would have fallen within the exceptions for advance board approval.³³³ The bill's sponsor could not come up with any other threatened or actual takeovers to justify the bill.³³⁴ Thus, the Act would have provided no protection against the only two concrete examples of "harm" to Nebraska that its sponsors pointed out.

Even if one accepts the rationale that hostile takeovers harm communities and employees, the Nebraska Act is of questionable value. Nothing in the Act prevents a business from closing a plant or laying off local employees in the pursuit of efficiency. Plant closings and layoffs of employees are not within the five-year ban on business combinations. Substantial sales of assets are covered, but only if the interested shareholder is itself a party to the transaction.³³⁵ A successful acquiring company trying to rid the target of an inefficient plant is unlikely to purchase that plant itself. Thus, once the tender offer succeeds, there is little in the Act to stop a disruptive layoff or relocation. Similarly, nothing in the Act prevents a corporation from terminating all charitable and other contributions to the community. Thus, the Act does not directly address such social concerns.³³⁶

Because the Act does not directly prohibit plant closings, relocations, or employee layoffs, its supposed beneficial effects in these areas

331. *Id.* at 9357 (statement of Sen. Johanns).

332. *See* NEB. REV. STAT. § 21-2442(1), (2) (Cum. Supp. 1988).

333. *See id.* §§ 21-2439, 21-2452.

334. In a candid statement, Senator Johanns said: "[D]oes Nebraska need this law right now? And the answer to that question is we really don't. There are no threatened takeovers occurring right now." *Debate, supra* note 35, at 9357 (statement of Sen. Johanns).

335. *See* NEB. REV. STAT. § 21-2437(2) (Cum. Supp. 1988).

336. One reading of the Nebraska Act might even encourage businesses to relocate to other states. The Act, it will be recalled, only applies to "issuing public corporations." *See id.* § 21-2442. What happens if the corporation ceases to be an issuing public corporation after the Act has been triggered? Do the limitation on voting rights and the ban on business combinations still apply? Assume, for example, that a Nebraska corporation is covered by the Act solely because its principal executive offices are in Nebraska. *See id.* § 21-2442(1)(b)(i). A tender offeror then acquires more than 20 percent of the corporation's stock, triggering both the restriction on voting rights and the ban on business combinations. Could the acquiring person avoid the Act's restrictions once he gained control of the board by moving the company's principal executive offices outside the state of Nebraska?

must come from its general deterrence of takeovers. First, the Act must make hostile takeovers less likely. Second, those people making hostile tender offers must be more likely to harm the community than existing management. This latter premise is questionable. Gelfond and Sebastian conclude:

[T]here is no basis for expecting an offeror to be less socially responsible than a target. To permit the target to judge the more responsible of the two and take actions preventing the shareholders from selling control of the company to the offeror guarantees no social improvement. If, for example, a successful

The corporation would cease to be an "issuing public corporation," but would that retroactively remove the disqualifications imposed by the Nebraska Act?

The voting rights limitation probably would not be affected. Section 21-2451 limits the voting rights of "[s]hares acquired in a control-share acquisition" which is the acquisition of the requisite amount of stock of an issuing public corporation. *Id.* § 21-2439. This definition seems to look to the time of acquisition. When the shares were acquired, the target clearly was an issuing public corporation, and there is nothing in section 21-2451 that would remove the voting rights limitation when the target ceases to be an issuing public corporation. The shares would remain "shares acquired in a control-share acquisition" and remain disqualified from exercising full voting rights.

The ban on business combinations is more problematic. Section 21-2452 prohibits business combinations between an issuing public corporation and any interested shareholder. Read literally and in isolation, this would require a court to look at the target's status as of the date of the proposed combination; is the corporation about to engage in the transaction an "issuing public corporation?" If not, because of a prior move of the corporation's headquarters or the loss of some other Nebraska contact, then section 21-2452 would not apply. This reading would allow an interested shareholder to circumvent the ban on business combinations by first moving the corporation's headquarters from Nebraska.

However, the definition of "issuing public corporation" specifies that "[f]or purposes of section 21-2453 only," a corporation's issuing public corporation status is to be determined as of the share acquisition date in question. *Id.* § 21-2442(1), (2). In other words, for purposes of section 21-2453 only, it does not matter that the issuing public corporation later ceases to meet the definitional requirements. However, the reference to section 21-2453 makes no sense. Section 21-2453 lists situations in which the Act does not apply. Read literally, the Act thus says not to look to the original share acquisition date in deciding whether the business combination is prohibited by section 21-2452, but only in deciding if a statutory exception to the ban applies. What the Legislature obviously meant to say was that a subsequent loss of issuing public corporation status would not prevent the ban on business combinations from operating, but the statute is worded most inartfully on this point. A literal-minded court might hold that the business combination ban could be circumvented by causing the corporation to lose its issuing public corporation status. If so construed, the Act creates a perverse incentive for the successful acquirer to move its business from Nebraska.

If the Act is construed only to require issuing public corporation status at the time of the acquisition, then a constitutional problem emerges. If a foreign corporation moves its principal executive offices elsewhere and sells its Nebraska assets, what basis does Nebraska have to continue to regulate the corporation? A continued application of the Nebraska Act after these Nebraska contacts cease is purely extraterritorial regulation with severe commerce clause problems of the type condemned in *MITE*. Nebraska has no continuing state interest to justify the continued application of the Act.

offeror fires target employees, but also cuts pollution and improves racial hiring practices, who can say that the offeror is less socially responsible than the target?³³⁷

Plant closings and layoffs are commonly undertaken by incumbent management as well, with the same negative effects on local communities and employees.³³⁸ Professor Jensen in 1984 was unable to find any evidence that takeovers produce more plant closings, layoffs, and dismissals than would otherwise have occurred.³³⁹ The Act does not in any way deter existing management from taking such actions. Thus, it is not clear whether the Act would make plant closings and employee layoffs more or less likely. One might argue that many corporate restructurings by existing management are defensive—designed to make hostile acquisitions less likely—and that the Act would render such restructurings less necessary. However, incumbent management usually seeks as many defenses against hostile offers as possible. The Act might make hostile takeovers less likely, but a restructuring, including plant closings and layoffs, still might be used as an additional defense. The Act is weak enough that reliance on the Act alone is probably inadvisable.

The disruption and dislocation argument also ignores the possible benefits to the community and employees of hostile takeovers. The synergistic gains and increased managerial efficiency potentially associated with takeovers could result in an expansion of the company's business rather than a contraction. This would result in even greater employment and benefits to the community than before. The Act would make it more difficult for such value-creating acquisitions to occur. In addition, even if the local plant is sold, those assets must be purchased by someone. The purchaser may itself plan to operate the local facility, in which case the net gain or loss to the community is indeterminate. Only if the local assets are scrapped does local employment necessarily suffer.

Finally, the disruption and dislocation argument assumes that the incumbent management should have unchecked power to pursue social and charitable goals at the expense of profit. Tender offers do not

337. Gelfond & Sebastian, *supra* note 234, at 459.

338. See, e.g., Krasnowsky, *Goodyear Threatens to Move Hose Division*, Lincoln Star, Aug. 3, 1988, at 1, col. 1 (Goodyear Tire and Rubber threatening to move its hose production to a new plant, costing Lincoln over 700 jobs, unless the hose division shows a five percent profit by March 1989); Goodsell & Gersten, *Consolidation Closing U.P.'s Shops in Omaha*, Omaha World-Herald, July 1, 1988, at 1, col. 1 (Union Pacific to close its locomotive and car repair shops in Omaha and relocate much of the work to Arkansas, costing Omaha 810 jobs, representing a payroll of \$23.6 million).

339. Jensen, *supra* note 323, at 114. But see S. BRUE, LOCAL ECONOMIC IMPACTS OF CORPORATE MERGERS: THE NEBRASKA EXPERIENCE (1972)(arguing that mergers of Nebraska corporations with outside acquirers lowered employment within the state).

prevent management from pursuing such goals but merely give shareholders the ultimate decision as to how much of their money should be devoted to such goals.³⁴⁰ Taking that ultimate control away from shareholders, who bear the residual risk of the corporation, in effect allows these other groups to play with the shareholders' money.³⁴¹ The Nebraska Act, in trying to protect local communities and employees, in effect imposes a tax on corporate shareholders in order to subsidize inefficient local operations.

Takeovers generally improve economic efficiency, which benefits the economy as a whole.³⁴² Changes that increase long-run social welfare often produce dislocations that reduce the short-run welfare of some individuals. The argument for protecting local plants and employees is both inefficient and provincial. It is inefficient because it encourages companies to keep pouring capital into local plants and employees even when other uses of the money would be more productive.³⁴³ It is provincial because it ignores the benefits to the communities in which the corporation's new employees and new plants will be located.³⁴⁴ Today's loss of a Nebraska plant because of a hostile takeover is tomorrow's gain when a successful Nebraska bidder moves the operations of an acquired target to Nebraska.

Professor Coffee focuses on the layoffs of one particular type of employee—corporate managers. He argues that hostile takeovers may substantially impair the efficiency of the managerial labor market.³⁴⁵ Coffee points out that managers may be overinvested in firm-specific human capital and that hostile takeovers, which often result in firings of incumbent management, destroy that investment. Existing managers may have traded off salary for implicit promises of long-term employment stability, only to find their expectations frustrated when a hostile takeover occurs. Managers may demand greater compensation to offset the increased risk that they will lose their investment. Inefficient companies may find it difficult to retain their best existing managers or to attract new managerial talent because of the risk. The demoralization resulting when a hostile takeover is imminent may actually harm the corporation:

340. Gilson, *supra* note 224, at 862-65. See also Easterbrook & Fischel, *supra* note 226, at 1191-92.

341. Jensen, *supra* note 323, at 111.

342. See *id.* at 114 ("even if takeovers lead to plant closings, layoffs, and dismissals, their prohibition or limitation would generate real social costs and reduce aggregate human welfare because of the loss of potential operating economies.").

343. If the local facility were the most productive use of the company's money, the bidder would have no incentive to close the local plant. Even if the local plant were sold to obtain cash, the buyer would still find it profitable to operate the plant rather than closing it. It makes sense to close a plant only when a greater return could be earned elsewhere.

344. Easterbrook & Fischel, *supra* note 226, at 1191 n.84.

345. Coffee, *supra* note 226, at 1234-43; Coffee, *supra* note 305, at 73-81.

The divisional or more senior manager who has performed diligently but who knows that management tends to be replaced as a team following a takeover has little motivation to perform, and every incentive to shirk, once a takeover appears imminent. He also has an increased incentive to engage in predatory self-dealing that reduces shareholder wealth.³⁴⁶

The extent of the problem pointed out by Coffee is unclear. To some extent, managers can protect themselves contractually. Coffee admits that management can protect itself through a properly drafted severance compensation provision—a golden parachute.³⁴⁷ Also, the hostile bidder has an incentive to retain the good managers, although there may be a problem identifying those people. The possibility of retention lessens the disincentives caused by the imminence of a hostile takeover. Managers have an incentive to continue performing well so that the bidder does not misidentify them as inefficient managers needing to be replaced.

Even if a problem remains after contractual solutions, the Nebraska Act does nothing to correct that problem. A hostile bidder remains free to control the board and replace existing management even without a shareholder vote. Nothing in the five-year ban on business combinations prohibits the removal of existing management. A bidder might be unwilling to proceed with the offer unless the shareholders grant full voting rights, but the shareholder vote is unlikely to protect management. The rational shareholder exiting the corporation would be concerned only about the size of the premium the bidder was paying and would have no incentive to worry about protecting management. A tender offer offering shareholders what they believe to be fair compensation is unlikely to be rejected in order to protect managerial interests. Thus, even if hostile takeovers do impair the efficiency of the managerial labor market, the Nebraska Act is not the solution.

5. *Curtailing Inefficient, Empire-Building Expansion*

Another argument often made against takeovers is that they represent empire-building by the bidder that provides no real economic gain

346. Coffee, *supra* note 226, at 1242.

347. Coffee, *supra* note 305, at 75-81. Golden parachutes and tin parachutes, providing large severance payments to upper-level and lower-level management in the event of takeovers or certain restructurings, are prime examples of contractual protections against the risk to management associated with takeovers. Contractually-negotiated plant closing notice provisions are another example. Although there are some transaction costs associated with the negotiation of such contractual provisions, the companies most likely to be subjected to hostile takeovers are of such a size that the transaction cost per worker should be relatively small, assuming collective bargaining. Thus, if the loss to employees is sufficiently important, transaction costs should not prevent the negotiation of such provisions.

to the *bidder's* shareholders.³⁴⁸ This argument hypothesizes that the bidder's managers overpay for target companies in order to maximize the size of the bidding firm. There are a number of reasons why the bidder's management might be willing to pay an economically unjustified premium in the pursuit of firm growth:

- (1) executive compensation and associated perquisites tend to be a function of firm size; (2) increased size in turn implies increased immunity from a hostile takeover; (3) acquisitions dilute the stockholdings of existing large shareholders and thereby confer increased autonomy on the management of the bidder; and (4) expansion both provides an opportunity for advancement within the corporate hierarchy for younger managers and justifies the continued employment of those who are acquisition specialists.³⁴⁹

Under this view, a successful takeover represents a transfer of wealth to the target shareholders, who are overpaid, from the shareholders of the bidder, who receive an asset—the target company—worth less than the value paid.

To the extent that such takeovers involve transaction costs and produce no overall gains, they are economically wasteful. However, the Nebraska Act is ill-suited to respond to such a concern.³⁵⁰ The Nebraska Act's approach is to place more discretion in the hands of target shareholders and target management, neither of which is a plausible proxy for the interests of the bidder's shareholders. The underlying premise of the empire-building hypothesis is that the bidder pays an amount to the target shareholders greater than the value of the target shareholders' interests. Target shareholders could protect the bidder's shareholders only at their own financial sacrifice. They are unlikely to use their disapproval of control share voting rights to block a tender offer that gives them a windfall gain. Target management has incentives to block a bid even in some cases where the bidder is overpaying, and the Nebraska Act might help them do it. However, management's incentives to block a bid are in no way positively correlated with whether the bidder is overpaying. If anything, target management's position imperfectly mirrors that of the bidder's shareholders—the higher the bid, the more likely it is that the bid will be accepted. Thus, the target's management is also a poor proxy for the interests of the bidder's shareholders. If the bidder is willing to pay an excessive price to acquire the target, the Nebraska Act, in giving the target shareholders and management greater bargaining power to demand a higher bid, encourages even greater transfers of wealth from bidder shareholders to target shareholders.

348. See Coffee, *supra* note 226, at 1167-69, 1224-29; Easterbrook & Fischel, *supra* note 226, at 1185.

349. Coffee, *supra* note 226, at 1224.

350. Indeed, one might ask why the Nebraska Legislature would pass a statute that takes windfall gains away from the shareholders of Nebraska corporations in order to protect the shareholders of non-resident bidders.

In addition, the Nebraska Act, to the extent that it deters takeovers, actually makes it harder for the bidder's shareholders to control the empire-building behavior of their management. The threat of a takeover disciplines the bidder's management. If the bidder has a policy of empire building and unprofitable acquisitions, the bidder would itself become a takeover candidate because the price of its stock would fall.³⁵¹ Because it discourages hostile takeovers, the Nebraska Act makes it more difficult for the bidder's shareholders to police their own management, and in this way makes inefficient, empire-building takeovers more likely to occur.

VI. APPLICATION OF THE ACT—MAKING AN OFFER

An investor contemplating a hostile tender offer for a corporation covered by the Nebraska Act must deal with the Act's voting rights limitation and its five-year prohibition of business combinations. Circumventing those provisions will not be easy, but, in many cases, it is not clear that a bidder would want to incur the cost to work around the Act. The costs of staying within the Act may not be that great.

The Act also poses problems for investors in friendly transactions—transactions with the target company approved by the target's board of directors or transactions with controlling shareholders. In each of these cases, the Act may have unintended consequences that will trap the unwary.

A. The Act's Effect on Hostile Offers

1. *Why Bother?*

The first question to be confronted in discussing how to deal with the Nebraska Act's restrictions on voting rights is—"why bother?" Shares acquired in a tender offer that constitutes a control-share acquisition still have full power to elect directors.³⁵² A bidder who successfully acquires more than half of the target corporation's voting stock will, therefore, control both the board and the policies of the corporation.³⁵³ The directors elected by a successful bidder are free to take any action consistent with their fiduciary duties that does not require a shareholder vote.³⁵⁴ The successful bidder's board can fire the

351. Easterbrook & Fischel, *supra* note 226, at 1185; M. Mitchell & K. Lehn, *Do Bad Bidders Become Good Targets?* (Office of Economic Analysis, SEC Aug. 1988).

352. NEB. REV. STAT. § 21-2451 (Cum. Supp. 1988).

353. "All corporate powers shall be exercised by or under the authority of, and the business and affairs of a corporation shall be managed under the direction of, a board of directors, except as may be otherwise provided in the Nebraska Business Corporation Act or in the articles of incorporation." *Id.* § 21-2035.

354. Control shares would be disqualified from voting on the following matters requiring a shareholder vote under Nebraska law: the issuance of rights or options to directors, officers, employees, or a subsidiary of the corporation, *id.* § 21-2019; the

old officers and hire new officers, drop certain business lines, change the business policies of the corporation, close plants, and even sell corporate assets and facilities as long as those assets and facilities do not constitute substantially all of the corporation's assets.³⁵⁵ Any bidder

ratification of contracts with directors, *id.* § 21-2040.01; a distribution out of capital surplus not authorized in the corporation's articles of incorporation, *id.* § 21-2044(2); amendment of the articles of incorporation, *id.* § 21-2057; a merger or consolidation, *id.* § 21-2072; a sale of substantially all of the corporation's assets not in the regular course of business, *id.* § 21-2078; and the voluntary dissolution of the corporation or the revocation of voluntary dissolution proceedings, *id.* §§ 21-2083, 21-2087 to -2088.

One particularly troublesome problem relates to the NBCA provisions for the premature removal of directors. The NBCA allows directors to be removed, with or without cause, at a meeting called expressly for that purpose. *Id.* § 21-2039. Directors may be removed only "by a vote of the holders of a majority of the shares then entitled to vote at an election of directors." *Id.* Nothing in section 21-2039 says that all shares entitled to vote for the election of directors are also entitled to vote for removal; the previously quoted provision can be read as only specifying how many votes must be cast for removal to be effective. Section 21-2451 of the Shareholder Protection Act says that control shares can vote only to elect directors, presumably denying them the right to vote to remove directors.

This creates two problems for a successful bidder. First, an acquiring person cannot use the removal provisions to replace the unfriendly board immediately, but must wait until the next regular election of directors. That result may have been intended. Second, section 21-2451 presents problems after the acquiring person has had a chance to elect directors. Suppose that the acquiring person becomes dissatisfied with the performance of a director. If section 21-2451 prohibits the acquiring person from voting on removal, he has no way to prematurely remove that director. However, since he retains the right to vote out the unsatisfactory director at the annual meeting, this problem is minor.

A more important problem is presented when the acquiring person owns less than fifty percent of the shares, but manages to control one or more directorships through cumulative voting. If the acquiring person is unable to vote against removal, the majority has sufficient votes to remove the directors affiliated with the acquiring person. Section 21-2039 attempts to protect the rights of the minority in the usual case by providing that "no one of the directors may be removed if the votes cast against his removal would be sufficient to elect him if cumulatively voted at an election of the entire board of directors." In a removal proceeding unaffected by the Shareholder Protection Act, the minority shareholder would vote against removal of his directors and thereby protect the minority directors. However, section 21-2451 of the Act appears to deny the minority acquiring person the right to vote against removal, since the removal proceeding is not an election of directors. Therefore, there will not be sufficient votes cast to protect the minority director. The majority could deny representation to the minority acquiring person by removing his directors using the section 21-2039 procedure, then having the majority-dominated board fill the vacant slot using section 21-2038. Thus, although the minority acquiring person could use cumulative voting rights at each annual meeting to get representation on the board, the majority could use removal powers to quickly replace that minority representative until the next annual meeting and so on *ad infinitum*. This possibility is a practical reason to read section 21-2451 of the Act creatively to grant control shares voting rights not only to elect directors, but also to vote on their removal.

355. The NBCA requires shareholder approval for a sale by the corporation of sub-

who intends only to continue operating the corporation as a separate entity and is willing to live with minority ownership³⁵⁶ should not be significantly deterred by the Act.

However, some people would be unwilling to live with these restrictions, and the Act, therefore, would deter some takeovers. A takeover may be valuable to the bidder only if the acquiring company can be merged with the target to achieve synergistic gains. The bidder may find it necessary to finance his bid using the assets of the target as collateral, and this may be possible only through a second-tier transaction. The bidder may not want to incur the administrative costs and procedural hassles associated with minority ownership. In such cases, the bidder may be willing to proceed with the takeover only if some way can be found to circumvent the restrictions of the Act.

2. *Application of the Act to Hostile Offers*

Hostile bidders have several ways to try to circumvent the Act, but none of these is completely effective. The easiest way for a hostile bidder to avoid the Act's voting rights limitation is to never acquire twenty percent of a covered corporation's stock. As long as the buyer stays below the twenty percent threshold, his shares retain full voting rights.³⁵⁷ The easiest way for a hostile bidder to avoid the Act's ban on business combinations is to never acquire ten percent of a covered corporation's stock.³⁵⁸ Thus, as long as a person is willing to limit his ownership of the corporation's stock, he need not worry about the Act. However, those levels of ownership are insufficient for a hostile bidder to wrest control of the corporation from incumbent manage-

stantially all of its assets. *Id.* § 21-2078. An acquiring person without full voting rights, of course, would be unable to vote on such a transaction. *Id.* § 21-2451. Any sale to which the acquiring person was a party would be a business combination prohibited during the first five years of the acquiring person's control. *Id.* §§ 21-2437(2), 21-2452.

356. The minority could not be cashed out in the first five years after the takeover because of the section 21-2452 prohibition on business combinations. Even after the five-year ban expired, an acquiring person without full voting rights could not vote on a cashout transaction. *Id.* § 21-2451. Thus, after the five-year period expired, an acquiring person without full voting rights could cash out the minority only if he could convince a majority of the minority shareholders to approve the transaction.
357. An acquisition is not a "control-share acquisition" unless the twenty percent threshold is crossed. *Id.* § 21-2439. Only shares acquired in a control-share acquisition have limited voting rights. *Id.* § 21-2451. If the person already owned more than twenty percent prior to the Act's effective date, acquisitions still present no problem unless they cause the person to cross one of the two higher thresholds—33 1/3 percent or 50 percent. *Id.* § 21-2439.
358. The Act prohibits business combinations with interested shareholders. *Id.* § 21-2452. A person is not an interested shareholder until he acquires ten percent or more of the corporation's stock. *Id.* § 21-2440.

ment, so a hostile bidder seeking control must find some other way around the Act.

The Act has carefully guarded against the most obvious way to avoid passing a threshold while obtaining control—a number of smaller acquisitions by separate but related parties. The Act defines two or more persons acting together as a single acquiring person,³⁵⁹ and the definition of ownership includes ownership by affiliates and associates.³⁶⁰ Thus, any coordinated strategy where each of several persons acquires just under the minimum percentages of the target's stock will still trigger the voting rights limitation and the restriction on business combinations.

The Act also discourages step transactions, where majority ownership is acquired in a series of technically separate acquisitions. Suppose, for example, that a person purchased nineteen percent of the corporation's stock, then an additional 1.1 percent to cross the twenty percent threshold, then an additional twelve percent. The Act only limits the voting rights of shares acquired in a "control-share acquisition" which is an acquisition that causes the acquirer to pass one of the three voting thresholds. The acquisition in the example that actually causes the acquirer to cross the twenty percent threshold is the 1.1 percent purchase. If the control-share acquisition could be limited to this single transaction, then the buyer would still have full voting rights as to the remaining thirty-one percent of his stock. However, the Act makes this very difficult. All shares acquired within a single 120-day period are treated as having been acquired in the same acquisition.³⁶¹ Thus, a step transaction would work only if a 120-day delay separated each of the steps. It would take over 600 days to acquire majority ownership in a step transaction designed to minimize the loss of voting rights.³⁶² But even a 120-day delay between steps would not

359. *Id.* § 21-2434.

360. *Id.* § 21-2443.

361. *Id.* § 21-2439. This provision raises an interesting issue. When two 120-day periods partially overlap, which shares are treated as part of the same control-share acquisition? For example, suppose that the purchaser acquires an initial ten percent of the corporation's stock on day one, another eight percent on day sixty, and an additional three percent on day 150. This last acquisition pushes the purchaser above twenty percent ownership and is therefore a control-share acquisition. The eight percent purchase clearly is part of that same control-share acquisition under the 120-day rule, and, therefore, is also subject to the voting rights limitation. But what about the initial ten percent purchase? It was not acquired within 120 days of the purchase which exceeded the threshold, but it was acquired within 120 days of the second purchase, which is part of that same control-share acquisition. Section 21-2439 provides that all shares "acquired within a one-hundred-twenty-day period . . . shall be deemed to have been acquired in the same acquisition," but within a 120-day period of what? Does this mean within 120 days of the purchase that gives the buyer twenty percent or within 120 days of any purchase that is part of the same control-share acquisition?

362. Suppose that the purchaser bought nineteen percent of the target's stock on day

guarantee success. Transactions more than 120 days apart are still treated as part of the same acquisition if they are acquired "pursuant to a plan to make a control-share acquisition."³⁶³ Since careful planning of the overall transaction is the essence of a successful step transaction, a series of purchases is probably a single control-share acquisition, and all of the shares acquired, therefore, would have limited voting rights.³⁶⁴ A series of acquisitions will be treated separately only if: (1) each is more than 120 days apart from any other; and (2) none is made in contemplation of any of the others.³⁶⁵ This is an extremely limited exception.

Another alternative an acquiring person might consider is to reincorporate the target in another state that does not have limitations such as those in the Nebraska Act. Because the voting limitation and the ban on business combinations are purely statutory, they presumably would not survive a change in the state of incorporation.³⁶⁶ However, reincorporation would require an amendment to the corporation's articles of incorporation which would require the approval of two-thirds of the shareholders entitled to vote.³⁶⁷ An acquiring person without full voting rights would be unable to vote on this amendment.³⁶⁸ Reincorporation thus makes little sense from the standpoint of the voting rights limitation. If the acquiring person can obtain two-thirds approval from the other shareholders to reincorporate merely to restore his voting rights, then he could much more easily obtain a majority vote under the Act to restore those vot-

one, waited 120 days, then bought an additional one percent, crossing the twenty percent threshold. This one percent would not have full voting rights, as it was acquired in a control-share acquisition. On day 240, 120 days later, the purchaser buys another thirteen percent, now owning a total of thirty-three percent. On day 360, the purchaser buys another .4 percent, crossing the 33 1/3 percent threshold and resulting in another control-share acquisition. On day 480, the buyer purchases another 16.5 percent and now owns a total of 49.9 percent. On day 600, the buyer purchases another .2 percent, crossing the final control-share acquisition threshold. This .2 percent would again be limited voting stock. The buyer now owns 50.1 percent of the target's stock and, assuming that each of these step transactions is respected as a separate acquisition, only 1.6 percent of the stock would have limited voting rights. *But see infra* text accompanying notes 363-64.

363. NEB. REV. STAT. § 21-2439 (Cum. Supp. 1988).

364. The information statement filed by the acquiring person would have to disclose all of the shares to be acquired as part of the overall plan. *Id.* § 21-2449(1)(d).

365. It is unclear who has the burden of proving that separate purchases are or are not part of a single overall plan. It often might be difficult for the target corporation to prove that purchases made more than 120 days apart were pursuant to a plan, since such a plan is unlikely to be in writing or even openly discussed.

366. This discussion assumes that the Nebraska Act is unconstitutional as applied to foreign corporations. *See supra* text accompanying notes 144-71.

367. NEB. REV. STAT. § 21-2057(3) (1987).

368. *Id.* § 21-2451.

ing rights.³⁶⁹ The business combination ban, however, contains no exceptions for shareholder approval. Thus, an interested shareholder could not engage in a business combination with the corporation even if all of the minority shareholders approved. This prevents even beneficial transactions from occurring. Reincorporation would provide a way around the absolute five-year ban on business combinations. If the interested shareholder can convince two-thirds of the minority shareholders that the transaction is beneficial, they could reincorporate in another state and avoid the Nebraska Act entirely.

The simplest way to acquire full voting rights in a hostile tender offer under the Act is to leave the offer open long enough for voting rights to be approved. If the offer is kept open for longer than fifty days, the bidder can file an information statement at the beginning of the offer and demand a shareholder meeting to determine voting rights.³⁷⁰ The target would have to hold that meeting before the tender offer closed. The bidder could actively participate in this shareholder voting through proxy solicitation. The Act provides that an acquiring person may vote proxies solicited from non-related parties.³⁷¹ However, the bidder would not be able to vote any shares which it or related parties already owned.³⁷² If the shareholders approved full voting rights, the bidder could proceed with the offer. If shareholders refused to grant full voting rights to the bidder, the bidder could terminate the offer.

A similar way to circumvent the Act would be to make the tender offer conditional on subsequent approval of full voting rights.³⁷³ The bidder could close the offer after the minimum twenty-business-day period required by the SEC,³⁷⁴ but condition the actual purchase of the tendered shares on subsequent shareholder approval of voting rights. The bidder would not own those tendered shares, so the hold-

369. *See id.* But see *supra* text accompanying notes 64-66 (arguing that a subsequent vote to restore voting rights may in some cases not be allowed).

370. *See* NEB. REV. STAT. § 21-2450(1) (Cum. Supp. 1988).

371. "Interested shares" are precluded from voting to grant the acquiring person voting rights. *Id.* § 21-2451. "Interested shares" are shares owned by an acquiring person. *Id.* § 21-2441. "Acquiring person" includes one who proposes but has not completed a control-share acquisition, *id.* § 21-2434, but an acquiring person does not own shares solely because he holds a revocable proxy to vote those shares, if that proxy was acquired in a solicitation made to ten or more shareholders. *Id.* § 21-2443(2), (3).

372. An acquiring person "owns" shares held by affiliates, associates, and persons acting as a group with the acquiring person to acquire, own, or vote those shares. *Id.* §§ 21-2443, 21-2434.

373. This was suggested by the Supreme Court in *CTS* as a way to avoid a fifty-day delay under the Indiana Act. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1634 (1987). The SEC has indicated that such a procedure would be acceptable under the federal rules. *See* Interpretative Release Relating to Tender Offer Rules, Release No. 34-16623, Fed. Sec. L. Rep. (CCH) ¶ 24,284I (March 5, 1980).

374. Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a)(1987).

ers of those shares could still vote them,³⁷⁵ knowing that if they did not vote in favor of the bidder, their shares would not be purchased.

A proxy fight is another way around the Nebraska Act's ban on business combinations. Section 21-2452 does not apply if the interested shareholder's acquisition of shares or the proposed business combination was approved by the corporation's board of directors prior to the interested shareholder's share acquisition date.³⁷⁶ A hostile bidder could solicit proxies to elect a friendly board of directors before the bidder acquired ten percent of the target's stock.³⁷⁷ If the hostile bidder could gain control of the board before acquiring more than ten percent of the corporation's shares, board approval would stop the business combination ban from ever being triggered.

B. The Act's Effect on Friendly Transactions

1. *Application to Friendly Transactions with the Corporation*

The best way to acquire full voting power is in a friendly transaction agreed to by the target corporation's board. The Nebraska Act excludes from the definition of "control-share acquisition" the acquisition of control "pursuant to a merger or plan of share exchange effected in compliance with section 21-2070 if the issuing public corporation is a party to the agreement."³⁷⁸ Thus, if target management agrees to a combination, any stock acquired in such a merger or share exchange would have full voting rights. A friendly acquisition also could be done through a sale of all of the target's assets to the bidder, either for stock or cash. "Control-share acquisition" includes only acquisitions of the target's voting stock, and not other forms of combination. However, the corporation's shareholders would have to approve a merger or sale of assets in any case, so the offeror still would have to get shareholder approval even with management's approval of the deal. If the bidder insisted on doing the acquisition by tender offer, for tax reasons or otherwise, the board alone could not insure that the bidder would acquire full voting rights. The issue would have to be submitted to a vote of the shareholders,³⁷⁹ and the bidder would acquire full voting rights only if management could per-

375. "Interested shares" are precluded from voting to grant the acquiring person voting rights. NEB. REV. STAT. § 21-2451 (Cum. Supp. 1988). "Interested shares" are shares owned by an acquiring person. *Id.* § 21-2441. An acquiring person does not "own" tendered stock which has not yet been accepted for purchase. *Id.* § 21-2443(2). Therefore, the tendered shares would not be interested shares and would be eligible to vote to approve full voting rights.

376. *Id.* § 21-2452.

377. This solicitation of proxies would not make the bidder the owner of the solicited shares. *Id.* § 21-2443.

378. *Id.* § 21-2439.

379. *Id.* § 21-2450.

suade a majority of the shareholders—excluding the bidder and related parties—to go along.³⁸⁰

If the offeror does not “own” ten percent of the target’s stock at the time of a friendly transaction, the ban on business combinations in section 21-2452 presents no problem. Section 21-2452 does not apply if the interested shareholder’s acquisition of shares was with the prior approval of the board of directors.³⁸¹ However, once the bidder obtained ten percent of the corporation’s shares, he would become an interested shareholder, and any subsequent transactions with the corporation, whether or not approved by the target’s board, would be barred by the business combination prohibition.³⁸² Thus, the Act would make more difficult a common pattern in takeovers—a bidder acquires a substantial stake in the company, makes an initially hostile tender offer, and after an increase in consideration or some other change, the board agrees to the transaction.³⁸³

2. *Application to Transactions with Controlling Shareholders*

The Act also poses a problem in sales of control by controlling shareholders. If the selling shareholder acquired his majority shares prior to the effective date of the Act, those shares would have full voting rights when transferred, because such a transfer is exempted from the definition of “control-share acquisition.”³⁸⁴ However, if the selling shareholder acquired majority control after the effective date of the Act, or if the seller owns less than fifty percent of the corporation’s stock, the transfer would be a control-share acquisition and the buyer would not automatically acquire voting rights.

At first glance, this appears to be a relatively minor inconvenience. The selling shareholder could simply use his voting power to approve full voting rights at a special meeting called for that purpose. However, the selling shareholder might find himself disqualified from voting at that meeting. An acquiring person is treated as the owner of

380. *Id.* § 21-2451.

381. *Id.* § 21-2452.

382. *Id.* The five-year prohibition on business combinations exempts transactions approved by the issuing public corporation’s board, but that approval must come before the person becomes an interested shareholder. *Id.* §§ 21-2452, 21-2445.

383. The business combination prohibition would not prevent an offeror from acquiring a ten percent stake and then making a tender offer, hostile or otherwise, for the corporation’s stock. A tender offer is not within any of the defined classes of business combinations. See *id.* § 21-2437. The closest category of business combination is § 21-2437(4)—any transaction involving the corporation or a subsidiary which increases the proportionate ownership of the interested shareholder. This does not apply because a tender offer does not involve the target corporation or its subsidiaries, but is a purchase directly from other shareholders.

384. *Id.* § 21-2439(f). Because the Act includes the holdings of affiliates and associates in the definition of ownership, *id.* § 21-2443, majority ownership need not be held by a single person to be exempted.

any shares which he has the right to acquire "pursuant to any agreement, arrangement, or understanding" or as to which the acquiring person has "any agreement, arrangement, or understanding for the purpose of acquiring" such stock.³⁸⁵ The selling shareholder and the buyer—the acquiring person—may have no binding contract of sale prior to the vote, but they certainly have an understanding that the seller will sell the stock to the buyer if the voting rights are approved.³⁸⁶ The acquiring person, therefore, would be deemed to own the controlling seller's stock and the controlling seller would be unable to vote his shares to approve the buyer's voting rights.³⁸⁷ The buyer would get full voting rights only if approved by a majority of the minority shareholders. This is problematic because the remaining shareholders may be unhappy that the controlling shareholder is not sharing the premium sales price with them. An alternative would be to proceed by tender offer. The controlling shareholder then could vote to grant the buyer full voting rights because stock tendered pursuant to a tender or exchange offer is excluded from the definition of

385. *Id.* § 21-2443(2)(a), (3).

386. The Act does not define the term "understanding," and there are no Nebraska cases defining the term. Nebraska Supreme Court cases using the word "understanding" tend to couple it in the disjunctive with "agreement" without discussing the difference between the two terms. *See, e.g.,* Mike Pratt & Sons, Inc. v. Metalcraft, Inc., 222 Neb. 333, 340, 383 N.W.2d 758, 763 (1986) (defining conspiracy as "an agreement or understanding between two or more persons to inflict a wrong or injury upon another"); Idaho Forest Indus. v. Minden Exch. Bank & Trust Co., 212 Neb. 820, 825, 826 N.W.2d 176, 179 (1982) (holding that because of "an agreement or understanding" between the parties, a payor bank was not liable for failing to return checks prior to the midnight deadline); First Nat'l Bank v. Omaha Nat'l Bank, 191 Neb. 249, 251, 214 N.W.2d 483, 485 (1974) ("in the absence of some agreement or understanding between the parties to the contrary, rent is not due until the expiration of the term").

Some courts in other jurisdictions have held that "understanding," especially as used by laymen, is synonymous with "agreement." *See, e.g.,* Reyes v. Boyd, 150 Cal. App. 167, 170, 34 P.2d 1058, 1059 (1934); Allison v. Horn, 249 Iowa 1351, 1355, 92 N.W.2d 645, 647 (1958); Travelers' Ins. Co. v. Evans, 101 Vt. 250, 257, 143 A. 290, 292 (1928); Southern Ry. v. Powell, 124 Va. 65, 69, 97 S.E. 357, 358 (1918). Other courts define "understanding" as anything mutually agreed upon. *See, e.g.,* Bullock v. Johnson, 110 Ga. 486, 491, 35 S.E. 703, 705 (1900); Ferguson v. D.S.A., Inc., 430 S.W.2d 553, 555 (Tex. Civ. App. 1968). On the other hand, other courts have held that an "understanding" is no more than an expectation or confidence falling short of a binding agreement or contract. *Domme v. Ostheimer*, 128 Conn. 31, 34, 20 A.2d 406, 407 (1941); *Camp v. Waring*, 25 Conn. 520, 529 (1857); *Williams v. Yazoo & M.V.R. Co.*, 82 Miss. 659, 666, 35 S. 169 (1903).

It is not clear that any of these definitions would prevent the problems noted in the text because the acquiring person probably would have some sort of agreement prior to the request for board approval, especially if the term is broadly read to include something short of a binding contract.

387. NEB. REV. STAT. § 21-2451 (Cum. Supp. 1988). The majority's shares would be "interested shares" because they would be "owned" by the buyer. *Id.* § 21-2441.

ownership.³⁸⁸ The problem with this solution from the controlling shareholder's standpoint is that the controlling shareholder would have to share the control premium with the other shareholders in a tender offer.³⁸⁹

The selling controlling shareholder might also use his control to obtain board approval of a merger or share exchange with the buyer. Such a merger or share exchange would not be a control-share acquisition,³⁹⁰ but it presents the same difficulty in getting the control premium to the controlling shareholder. Any major difference between the consideration going to the controlling shareholder in the merger and the consideration going to the minority would present serious fiduciary duty problems.³⁹¹

Thus, as to controlling ownership acquired after the effective date of the Act, the Nebraska Legislature may have inadvertently imposed the equal opportunity rule advocated by Professor Andrews.³⁹² A controlling shareholder can sell out only if he is willing to share the premium paid with the minority shareholders, unless his buyer is willing to accept reduced voting rights (in which case the buyer is unlikely to pay as large a premium).

The five-year ban on business combinations also presents a problem to the controlling shareholder attempting to sell his interest in the corporation. On the surface, it appears that a majority owner wishing to sell out could simply direct the board to approve the sale, and the buyer would not thereafter be prohibited from engaging in any "business combination." The Nebraska Act exempts transactions where the interested shareholder acquired his shares with the prior approval of the target's board.³⁹³ However, this board approval must come prior to the "share acquisition date" which is the date the person first becomes an "interested shareholder."³⁹⁴ As mentioned above, ownership includes "any agreement, arrangement, or understanding" giving the person a right to acquire the stock or for the purpose of acquiring the stock. By the time an acquisition is presented to the board for approval, there is almost certainly going to be an agreement

388. *Id.* § 21-2443(2)(a).

389. A tender offer or exchange offer must be open to all holders of the security sought. Rule 14d-10, 17 C.F.R. § 240.14d-10 (1987). If the offer was oversubscribed, the offeror could not prefer the controlling shareholder over the others but would have to accept the tendered shares on a pro rata basis. Securities Exchange Act of 1934 § 14(d)(6), 15 U.S.C. § 78n(d)(6)(1981).

390. NEB. REV. STAT. § 21-2439 (Cum. Supp. 1988).

391. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983) (majority shareholder in a cashout merger owes minority shareholders fiduciary obligations of fair price and fair dealing).

392. *See Andrews, The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 515 (1965).

393. NEB. REV. STAT. § 21-2452 (Cum. Supp. 1988).

394. *Id.* § 21-2445.

or understanding concerning the buyer's acquisition of the stock. It therefore will be very difficult for a person acquiring ten percent of the corporation's stock from a controlling shareholder to avoid the statutory prohibition on business combinations.

C. Application of the Act to Subsequent Offers

The Nebraska Act also has unintended consequences when more than one offer is made for the same corporation. If the Act is read literally, a person who makes a control-share acquisition is permanently barred from voting on whether to grant full voting rights to the shares of any other acquiring person. Suppose that Offeror A acquires fifty percent of the voting stock of Target Corporation, and that the Target shareholders meet and grant full voting rights to A's shares. Some time later, Offeror B acquires twenty percent of Target's voting stock, and forces a special meeting to consider the voting rights of B's shares. Clearly, B's shares are "interested shares," and B cannot vote on his own voting rights. But the term "interested shares" includes all voting stock "owned by an acquiring person,"³⁹⁵ not just shares owned by the acquiring person whose voting rights are being considered. Because "acquiring person" is one who makes a control-share acquisition,³⁹⁶ and Offeror A made a control-share acquisition, Offeror A is an acquiring person. Nothing in the Act ever terminates one's status as an acquiring person, so A's shares remain "interested shares" in perpetuity, forever barred by section 21-2451 from voting on future acquiring persons' voting rights.³⁹⁷

VII. CONCLUSION

In its third attempt to regulate corporate takeovers, the Nebraska Legislature, like the legislatures of many other states, has struck out. It has adopted a statute that is clearly unconstitutional in some respects and of debatable constitutionality in others. It has succumbed to popular, fatalistic arguments against hostile takeovers without

395. *Id.* § 21-2441 (emphasis added).

396. *Id.* § 21-2434.

397. Construing the Act so that A's status as an acquiring person terminates once the acquisition is completed would defeat the voting rights limitation. If A ceased to be an acquiring person upon completion of the acquisition, then A could vote to give his own shares voting rights. Section 21-2451 provides that "interested shares" may not vote on the question of whether to grant full voting rights to control shares, and "interested shares" are defined as shares owned by an acquiring person. *Id.* § 21-2441. If A ceased to be an acquiring person upon completion of the acquisition, then A could vote to grant himself full voting rights and section 21-2451 would only be a nuisance. An alternative construction would be to say that A ceases to be an acquiring person when A receives full voting rights. This would allow A to vote on the voting rights of B's shares. Unfortunately, there is nothing in the text of the Act to support this construction.

closely examining the economic reality behind those arguments. It has enacted a statute that penalizes investors in order to achieve dubious gains in terms of economic protection from competition with other states. Most importantly, in its excessive zeal to free corporate management from the market discipline of hostile takeovers, the Legislature has further removed corporations and their managements from the control of the investors whose money is at risk.

If these changes were confined to Nebraska, the damage would not be extraordinary. Unfortunately, the Nebraska Act is representative of legislation being enacted by states across the country. More and more, the long-standing idea of shareholder sovereignty is crumbling as states take away one of the shareholders' basic tools to control their corporations. Instead of protecting shareholders as promised, these statutes protect inefficient businesses and facilitate mediocrity.